

**ANTI-TERRORISM FINANCING:  
PROGRESS MADE AND CHALLENGES AHEAD**

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**HEARING**  
BEFORE THE  
**COMMITTEE ON FINANCE**  
**UNITED STATES SENATE**  
ONE HUNDRED TENTH CONGRESS  
SECOND SESSION

APRIL 1, 2008



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## **ANTI-TERRORISM FINANCING: PROGRESS MADE AND CHALLENGES AHEAD**

**TUESDAY, APRIL 1, 2008**

U.S. SENATE,  
COMMITTEE ON FINANCE,  
*Washington, DC.*

The hearing was convened, pursuant to notice, at 10:06 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Bingaman, Kerry, Wyden, Salazar, Grassley, Hatch, Kyl, and Crapo.

Also present: Democratic staff: Bill Dauster, Deputy Staff Director and General Counsel; John Angell, Senior Advisor; Mary Baker, Detailee; Cathy Koch, Senior Advisor, Tax and Economics; and Chelsea Thomas, International Trade Analyst. Republican staff: Emilia DiSanto, Chief Investigative Counsel; Jason Foster, Investigative Counsel; Lori Dillard, Detailee; Eben Roberts, Detailee; and Janet Drew, Professional staff.

### **OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The hearing will come to order.

The British terrorism expert Paul Wilkinson said, "Fighting terrorism is like being a goalkeeper. You can make 100 brilliant saves, but the only shot that people remember is the one that gets past you."

Today we will address the terrorism funding efforts of the Office of Terrorism and Financial Intelligence, the TFI, within the Treasury Department.

It has been 4 years since the TFI was created. It has been 4 years since the Finance Committee confirmed Under Secretary Levey as the administration's top anti-terrorism financing official. This is a good opportunity for the Finance Committee to reexamine this critical office.

This hearing is also timely, considering the CIA's latest warning. On Sunday, CIA Director Michael Hayden warned that Al Qaeda has been able to establish a safe haven along the Afghan/Pakistan border. We have to ask our terrorism fighters if they are letting some shots get past that goal, or get past them.

Mr. Levey, however, has been moving full speed ahead, and I commend him for his continuing commitment to this essential effort. Of course, his dedication and hard work will not prevent us from asking tough questions; a number of concerns remain.

Is the administration effectively coordinating the 19 Federal offices that work on terrorism financing? How is Treasury coordinating with the Justice Department, the FBI, the CIA, and the State Department? Has the National Safety Council been aggressive in bringing these agencies together?

Does the Treasury Department have the resources that it needs? At one point there was a report that the administration turned down a request for 80 IRS agents used exclusively for investigating terrorism financing.

Is the anti-terrorism financing staff expert enough to move through the increasingly complex international financial world? Are there enough Arabic speakers?

Is the office setting its priorities correctly? In 2005, the committee learned that 2 employees were assigned to go after Saddam's missing funds, and 2 employees were assigned to go after Osama bin Laden's money, but 21 employees were assigned to go after those who violate Cuba sanctions. That was in 2005.

The TFI has since increased the number of employees assigned to Al Qaeda and Iraq, but I want to be reassured that resources are wisely allocated. I want to hear that TFI's priority targets continue to be those who seek to harm Americans.

The focus on Osama bin Laden's network must be job one. I want to know what assets have been seized from Al Qaeda in the past 2 years.

In the *Los Angeles Times* article last week, Michael Jacobson, a senior advisor in the TFI until last year, said that "the international cooperation and focus is dropping the further we get from 9/11." I hope that Mr. Levey will react to this charge in his testimony.

We have also seen prosecutions failing in some high-profile trials involving charities suspected of having ties to terrorist organizations. What happened there? Were these prosecutions off-base? Does the administration need to do a better job of monitoring these organizations?

Also, on nonprofits, the report from the Treasury Inspector General for Tax Administration found that the IRS was using a limited terrorism watch list for checking the tax returns of nonprofits. I followed up by writing Secretary Paulson. The reply from the Acting Commissioner did not give me a lot of confidence that the administration is being aggressive enough in establishing links between nonprofits and terrorism financing.

Another interest of the Finance Committee is offshore tax evasion. A news story in just the past few weeks told us about tax evasion in Lichtenstein. Another reported on the Kellogg, Brown, and Root office in the Cayman Islands hiring Iraqi employees and not paying payroll taxes. These are reminders that offshore financial transactions threaten the revenue base of the Federal Government.

More importantly, it means that hardworking families are honestly paying their taxes while others send them offshore and do not pay a dime. TFI has powerful tools to investigate and stop terrorism financing overseas. At some point, we have to ask ourselves if they need to be used to combat offshore tax evasion as well.

I will also raise the issue of Stored Value Cards as a possible new terrorism financing method. I am concerned about a classified computer system that is behind schedule.

Money is the lifeblood of terrorism, and our government's efforts to locate and seize terrorist assets may mean the difference between life and death of American citizens. We appreciate Mr. Levey's continued commitment to the new TFI office. We commend you on what may be 100 brilliant saves, and we encourage you to continue to keep your teams focused on preventing that one shot that might get past you.

Senator Grassley?

**OPENING STATEMENT OF HON. CHUCK GRASSLEY,  
A U.S. SENATOR FROM IOWA**

Senator GRASSLEY. Thank you, Mr. Chairman, for calling this important hearing today to examine our efforts to understand and combat terrorism financing.

After the 9/11 attacks, our government rededicated itself to follow the money. We were aggressively freezing and seizing terrorist assets. We were naming and shaming terrorists by publicly designating their leaders and organizations as terrorists. This was, and continues to be, a key element of our counterterrorism strategy. As President Bush said, the goal was "a strike on the financial foundation of the global terror network."

We will hear today from the head of the Office of Terrorism and Financial Intelligence, Stuart Levey, about the progress and successes that have been made in this effort, as well as finding out about shortcomings. I look forward to hearing how Mr. Levey plans to deal with some of the challenges faced by his office.

Many have expressed concern that we could, and should, be doing a better job. According to an *L.A. Times* article just last week, some experts argue that, among our many problems, the U.S.-led coalition on this issue is deteriorating as countries like Saudi Arabia and Pakistan drag their feet. Terrorists have adapted their methods to get around the tools we use to stop them. The article also referred to our government agencies engaging in too much squabbling to cooperate effectively and get the job done.

Example: One former State Department U.N. terrorism finance official was quoted as saying, "Al Qaeda, the Taliban, and other terrorist groups continue to have access to the funds they need for active and expanded indoctrination, recruitment, maintenance, armament, and operations." Meanwhile, our government is reportedly distracted by infighting about who should be in charge. A recently departed Treasury official was quoted as saying, "There is a lot of elbowing and there isn't any cooperation."

There are also indications of some basic management issues that may need to be addressed within the office. For example, I have heard that the employee turnover rate may be as high as 30 percent in some components. No program can develop dedicated, experienced, core professionals if turnover rates are that high.

Because of the complicated interagency process involved, it can often take months to designate a terrorist individual or organization. The Treasury Department has even stopped reporting the amount of assets it freezes and seizes from Al Qaeda and affiliates.

The bottom line is that terrorists constantly adapt and improve their methods, and consequently so must our government.

The best way to stop terrorism is to get them where it hurts most: the pocketbook. To do this, we must remain vigilant against money laundering by ensuring that our laws keep pace with new and emerging trends that terrorists and criminals exploit to fund their activities. That is why I introduced the Combatting Money Laundering and Terrorist Financing Act of 2007, and I did that early last year. This bill seeks to close loopholes in the law and provide necessary tools for law enforcement to catch those who break the law.

As a sign of how fast these criminals and terrorists adapt, I have had to rewrite my bill in just the last year to account for some new and emerging trends. Example: Stored Value Instruments, such as prepaid credit and debit cards, are now being used to smuggle money in and out of the country. The amounts involved may be in the billions of dollars. This is something that was not included in the original bill.

I have added it in the new draft. I plan to introduce my updated version of this vital legislation in the near future and would ask my colleagues to take a look at it and support this effort to help cut off funding for terrorism and criminals around the globe. The Justice Department supported a previous version and is currently reviewing my new draft. The Secret Service, as well as Immigration and Customs Enforcement have also expressed support.

The Department of Treasury has stated that it supports some provisions of the new bill, but it has also raised some, in my estimation, vague concerns. The Department has agreed to sit down with my staff and discuss the bill later this week. Given the importance of this legislation and my goal of closing any loopholes in our law, I hope the Department will expedite its views on the bill so that we can take immediate action.

Another new concern is what is known as trade-based money laundering. International trade is increasingly being used to disguise money laundering and terrorism financing activities. Criminal organizations are using basic trade fraud, such as under- and over-invoicing, and multiple invoicing of goods and services to hide the proceeds of their illegal activities. Terrorist organizations also trade in drugs, gems, and precious metals to store and move their money undetected around the globe.

For instance, Afghan officials have stated that drug traffickers smuggle heroin out of the country, only to return with weapons and bombs. Money service systems such as hawalas can also be used to finance terrorism. These systems trade debt and payment through an informal network of brokers without the need to access traditional banking systems.

Now, it seems like the Treasury Department has done some things well in keeping known terrorists out of our financial system and encouraging other countries to adopt more stringent regulations to help achieve our goal worldwide. It should receive our praise for these important accomplishments.

However, this is a beginning. I am concerned that we are not doing enough to understand and address these alternative means of funding terrorist operations. Some say we should be satisfied to



just play defense. That is not good enough. It is not enough to declare a victory just because we think we have forced most terrorist funding outside the traditional banking system.

Instead, we need to stay on offense. We have terrorist organizations using a variety of methods to obtain their funding. They are experts at switching from one method to another whenever needed. But we are simply not prepared right now to keep up with them and put them out of business once and for all. We need to take the battle over terrorist funding to wherever the money flees. We need to understand how terrorism adapts and go after their new methods with the same urgency and purpose that we had in the weeks and months after 9/11. The Treasury Department ought to be at the forefront of analyzing, evaluating, and countering these new trends. I certainly hope that we hear today what is being done to accomplish that. Thank you.

The CHAIRMAN. Thank you, Senator.

We now turn to our witness, our one witness today, the Under Secretary for Terrorism and Financial Intelligence, Stuart Levey.

Mr. Levey, your complete statement will be in the record, but, since you are the only witness, we will give you more than 5 minutes. You can take at least 10, and we will take it from there. Thank you very much. Welcome to the committee. As I mentioned in my statement, I think you have been doing a pretty good job.

So the goal of this oversight hearing is essentially to compare notes on basically how we can do a better job in tracking down terrorism financing. We will have some tough questions to ask, but the mutual objective here is to get the job done. Thank you.

**STATEMENT OF HON. STUART A. LEVEY, UNDER SECRETARY,  
OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE, DE-  
PARTMENT OF THE TREASURY, WASHINGTON, DC**

Mr. LEVEY. Well, I very much appreciate that. Mr. Chairman, Ranking Member Grassley, distinguished members of the committee, I thank you for the opportunity to talk to you today about the work of our Office of Terrorism and Financial Intelligence, and for the support that we have received from this committee and the other committees that oversee us.

It has been nearly 4 years since I first testified here as a nominee for my current position, and I think it is fair to say that at that time there was a real question about what the Treasury Department's role would be, if any, in our national security architecture after our law enforcement functions were moved out of the Department.

Fast forward to today and I think the Treasury Department is playing a greater role in national security issues than it ever has before. The reason is that many of the threats that we face, as you indicated, from terrorism to proliferation of weapons of mass destruction, rely on financial support networks. We are well-positioned to address that aspect of the threats because of the authorities we have been given by the Congress, our relationships with governments and private sector actors around the world, and the information we can draw upon, especially now that we do have an Office of Intelligence and Analysis, the first such intelligence office in any finance ministry anywhere in the world.

As we approach these threats, we are increasingly employing conduct-based financial measures targeted at particular actors. When we use these targeted financial measures rather than impose sanctions on an entire country, it is easier to achieve a multilateral alignment of interests. Whatever the political views of a country, they all have a shared interest with us in keeping their financial sectors free from illicit conduct.

Even more significant is the reaction from the private sector. When we use targeted financial measures, the private sector becomes our ally. Banks do not want to jeopardize their reputations, and beyond that they really have no interest in dealing with terrorists, proliferators, and others of their ilk.

As a result, we have seen banks around the world voluntarily go beyond their legal requirements to cut off business with those that we identify as posing a risk. Such voluntary implementation, in turn, makes it more palatable for foreign governments to act with us because their financial institutions have already given up the business, and thus we can create a mutually reinforcing cycle of public and private action.

The written testimony that I submitted discusses how we have been using these targeted financial measures in a number of areas. I want to just talk about two this morning: terrorist financing, of course, and our work on Iran.

As the chairman and ranking member noted, tracking and combatting terrorist financing are critical pillars of our overall counterterrorism strategy. In December of 2005, the 9/11 Commission's Public Discourse Project gave its highest assessment to our overall efforts to combat terrorist financing, and we have continued to improve our efforts today.

To start, we have come a long way in our ability to map terrorist networks using financial intelligence and other information. Often, it is most useful for us not to take a public action, but to continue our intelligence work, to trace the terrorist network both upstream to find the ultimate donors, and downstream to find the operational cells. Often, we can then empower others around the world to act.

On some occasions, as Senator Grassley mentioned, we do publicly designate terrorist supporters, freezing their assets in the United States. With Al Qaeda and the Taliban, we seek parallel designations at the United Nations.

In the right case, the disruptive impact of these actions is very significant. Beyond the direct effect on the designated party, these designations can deter other donors. The operative who is willing to strap on a suicide belt may not be susceptible to deterrence, but the wealthy donor may well be.

These efforts do put pressure on terrorist networks. These networks require significant financing to survive, far beyond the cost of an individual attack. They need money to pay operatives, indoctrinate and train new recruits, travel, bribe public officials, and the like.

The key measure is what we have seen with respect to Al Qaeda, which is that we have made real progress in pressuring its financial network. That is the goal. We have disrupted and deterred many of its donors on which it used to rely. We have shut down,

by our designations, many of the charities that Al Qaeda previously depended upon.

Al Qaeda has had no choice but to turn to less reliable methods of raising, storing, and moving money, giving rise to opportunities for fraud and distrust within its ranks. It is difficult to operate an organization with just cash couriers. Some of them get caught and some of them get greedy.

Consider this relatively recent quote from a high-ranking official of Al Qaeda, Shaykh Sa'id. He said, "As for the needs of the Jihad in Afghanistan, the first of them is financial. There are hundreds wishing to carry out martyrdom-seeking operations, but they can't find the funds to equip themselves. So, funding is the mainstay of Jihad. Those who perform Jihad with their wealth should be certain to only send the funds to those responsible for finances and no other party, as to do otherwise leads to disunity and differences in the ranks of the Mujahideen."

DNI McConnell recently summarized the impact of all of these terrorism financing efforts, noting that over the last year to 18 months the core leadership of Al Qaeda has had difficulty raising funds and sustaining itself. I agree with you, that does not mean we can relax. There are many critical challenges facing us, some of which you alluded to and I am sure we will have a chance to discuss.

In my view, one of the toughest that we face is that it has proven difficult to persuade officials in some countries to identify and hold terrorist financiers publicly accountable for their actions. That lack of public accountability undermines our ability to create this deterrent effect. So long as that is the case, even when we are successful in disrupting terrorist facilitators and their financial conduit, our successes may be short-lived.

I want to spend a few minutes also briefing you on the steps we have taken with respect to Iran, which is not only pursuing a nuclear program in defiance of U.N. Security Council resolutions, but it also the world's foremost state sponsor of terrorism, and indeed the central banker of terrorism.

Iran uses its global financial ties and its state-owned banks to pursue its nuclear and ballistic missile programs, and to fund terrorism. In order to do so, it engages in an array of deceptive financial conduct. It uses front companies and cut-outs to engage in ostensibly innocent transactions that are actually related to its nuclear missile programs. We have seen Iran's banks request other financial institutions take their names off of transactions when processing them in the international financial system.

This practice, which is even used by the Central Bank of Iran, is intended to evade the controls put in place by responsible financial institutions and has the effect of threatening to involve those financial institutions in transactions that they would never engage in if they knew who or what was really involved.

Over the past year and a half, I, and many other senior Treasury officials, have met with government counterparts and with scores of private banks around the world to share this information and to discuss the risks of doing business with Iran. We have taken very aggressive targeted financial actions under our terrorist executive

order and our proliferation executive order against key Iranian banks, entities, and individuals facilitating the regime's conduct.

These efforts have been accompanied by simultaneous international action. For example, one of the major Iranian banks that we designated, Bank Seppa, has also been designated by the United Nations for its activity. In the most recent Security Council resolution, the Security Council called on all states to exercise vigilance over their financial institutions dealing with all Iranian banks.

As a result, we are seeing just the type of mutually reinforcing public and private action that I previously mentioned. The world's leading financial institutions have largely stopped dealing with Iran, and especially its banks, in any currency. The Iranian regime is fast turning its country's banking system into a financial pariah. This represents a substantial success in protecting the integrity of the financial system from Iranian illicit conduct, while also putting pressure on the regime.

Mr. Chairman, I believe that, with your support and the support of this committee, we have transformed the Treasury Department into an important part of our national security architecture. We have greatly improved our ability to analyze and use financial intelligence. We have developed and implemented strategies for combating terrorist financing and other pressing threats to our national security, including those posed by North Korea and Iran.

We have made important strides in strengthening the systemic safeguards in the United States and the international financial system, trying to learn about those new methods that I hope I have a chance to discuss with you during the questions and answers. But our work is not nearly complete, and I look forward to working with this committee as we go forward to tackle these important challenges in the spirit that you have indicated, Mr. Chairman. Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Levey.

[The prepared statement of Mr. Levey appears in the appendix.]

The CHAIRMAN. I have a lot of questions, and not enough time to ask them all.

I am going to start off with a somewhat narrow question. The TFI used to publish an accounting of how much had been seized from Al Qaeda, but in the past year the numbers have not been published, leading some to suspect that the seizures have trailed off. So, a couple of questions. Why are you no longer publishing the amount of assets seized? Second, has there been a trailing off or has it increased?

Mr. LEVEY. Mr. Chairman, I do not know the exact answer as to why we do not publish it. I will give you my opinion, which is, I do not think it is a useful metric. One thing I promised this committee when I was going through the confirmation process was that the way we would judge what actions to take and how we would try to conduct our terrorist financing activities was to try to put pressure on the ultimate target, to put pressure on the terrorist organization.

As I indicated in my testimony, sometimes the best way to do that is by simply following the money, trying to empower others to act in ways that you could imagine, given our public setting. That

is the most important message for fighting terrorism and using terrorist financing as part of an overall terrorism strategy. I think that, in the end, our efforts have been effective, as the Director of National Intelligence suggested, in the sense that we have put a lot of pressure on their financial network and they are having trouble raising funds.

The CHAIRMAN. I guess the question is, how is this committee or the public going to know that TFI has been accountable, that they are doing their job? It seems to me that there has to be some quantification, some measurement, some benchmark of some kind, certainly for this committee, and second, for the public.

Mr. LEVEY. Well, for this committee I have one answer. The public may be a little more difficult.

The CHAIRMAN. Or we can go in maybe a different setting to answer these questions. But it just seems to me there has to be some way for, at least this committee, and also for the public, to have some quantifiable information to know the degree to which your agency has been doing its job.

Mr. LEVEY. I completely agree. I am perfectly happy to brief any member of the committee in that context, because I do think that is the best way to judge it. What I do worry about, and what I told the committee during my confirmation hearing I worry about, is creating metrics that skew incentives. I do not want—

The CHAIRMAN. Well, what is the proper metric? What are some of the two or three proper metrics?

Mr. LEVEY. A proper metric is, what is the best way to put pressure on the target?

The CHAIRMAN. And the best way would be?

Mr. LEVEY. Well, it depends. I have these meetings twice a week, at least, where we sit down, we discuss a target. We have our Intelligence Office, which was created at the same time my office was created, present the intelligence as to what we know about that target, and then we discuss what our tools are. Sometimes are tools are simply, we should share this information with an ally. They are better positioned to act. They have authorities that are better. They can question this person. They could help us learn more. Sometimes we put out a confidential notice to our financial institutions, an authority that they have used over 750 times since the PATRIOT Act was passed, another authority given to us by the PATRIOT Act.

What I do not want to have happen is to have the person who is in charge of that meeting—in this case, me—worry about, gosh, I am going to favor the public designation because that will look better to the public.

The CHAIRMAN. You sit down in these meetings twice a week. Do you have a sense that you know all the targets? Do you know all the targets or not?

Mr. LEVEY. No, I am sure I do not. We certainly try hard.

The CHAIRMAN. By what percentage? What is your best guess? What percent of the targets out there that are meaningful in some way do you think you know?

Mr. LEVEY. That is an inherently difficult question to answer. I do think we know the important targets, and we try to make sure that we are focusing in terms of those that matter most. To get one

of the concerns in your statement, we do focus on Al Qaeda primarily because that is job one.

The CHAIRMAN. Yes. But do not forget, you are a goalie, too. You cannot let a shot get passed.

Mr. LEVEY. And I am very sensitive to that. I think I have a lot more gray hair than I did 4 years ago because of that.

The CHAIRMAN. So that is sort of unsettling. It leaves me really unsettled. That is, I do not get the sense that you have a good grasp of all the targets.

Mr. LEVEY. Well, we are talking about a global problem of terrorism.

The CHAIRMAN. It is.

Mr. LEVEY. There are a lot of terrorist organizations. Al Qaeda, as I mentioned in my written testimony, is affiliating itself with regional terrorist groups. There may well be things that we are still trying to learn, but this is, as you know, the highest priority for our intelligence community. We have access to all the intelligence that they collect and publish for us. What we try to do is focus on the targets that matter the most, the ones that are the highest priority, Al Qaeda being first among those, but not the only one. Certainly, as another example, we are focused on Iran's support to terrorism, which is also important.

The CHAIRMAN. I will have many more questions, but my time has expired.

Senator Grassley?

Senator GRASSLEY. I have drafted an updated version of S. 473, which I have shared with the Department. It would help target some of the new nontraditional ways that terrorists and criminals are moving money around the globe. Could you describe for me any concerns or suggestions you have for improving the legislation?

Mr. LEVEY. Senator Grassley, I am only familiar in general with the provisions of the bill. I know we are going to get together with your staff later this week and have detailed suggestions. There is much in that bill that I think we find possible. We certainly agree with the intent of the bill. I think we will be able to provide constructive comments to you later this week.

Just as an example, I know that the Treasury Department has previously supported—and I have no reason to doubt that we would continue to support—the addition of tax evasion as a money laundering predicate, which I think is an important thing. But I would rather let our detailed comments come through your staff; I can assure you, they are going to be constructive.

Senator GRASSLEY. All right.

I brought up infighting in my opening statement. My understanding is that it often takes months to designate a terrorist individual or entity, even when evidence is very clear. The interagency process requires unanimous agreement among many departments and agencies. It sounds like it may be too cumbersome.

The Financial Action Task Force, the Defense Department, and the Council of Foreign Relations have all suggested that we need to reexamine our efforts on this issue, and perhaps even create an anti-terrorism financial czar. This official could report directly to the White House and be final authority on interagency disputes. Would you please provide the committee with the detailed statistics

on the average time a designation package takes to completely go through the process? What do you think of the idea that there should be a terrorism financing czar?

Mr. LEVEY. Well, Senator Grassley, I think I certainly sometimes feel some of the frustrations of the interagency process, as I think any executive branch official does. But I do have to say that I would not necessarily equate debate and argument about what is the proper way to treat a problem with just bickering. I mean, I think there is something to be gained from different agencies having different views on how to treat a problem. So, while I probably experience just as much frustration as anyone else, I do not think that we should avoid having the input of all of the agencies that have an interest in these things.

I do think that having a counterterrorism financing czar would be counterproductive. I think the key thing, and what we have achieved over the last 4 years, is to make terrorist financing an integral part of the counterterrorism effort, and there is a counterterrorism czar, and we have a National Counterterrorism Center.

What we should be trying to do is making terrorist financing an integral pillar of a counterterrorism strategy rather than its own strategy. So I think that I've seen that recommendation. That was a recommendation that had been made back in 2003–2004. I do not think it would make our efforts more effective.

Senator GRASSLEY. I presume that you are going to provide the statistics in writing that I asked for?

Mr. LEVEY. I am going to attempt to provide those statistics in writing. I am not so sure that that is going to be readily available. We will do our best to get you information on that.

Senator GRASSLEY. Would you please provide detailed statistics on the employee turnover, the various components and subcomponents of your office? Do you have any subcomponents under your supervision where the turnover rate is approaching 30 percent? If so, is that not something that needs to be dealt with? I have also heard reports that analysts with Arabic language skills and Middle Eastern terrorism expertise have been assigned to work on Cuba issues. What are you doing to ensure that analysts are matched to tasks appropriate to their skills?

Mr. LEVEY. Senator Grassley, I got indication of that question this morning. In my quick check, I do not think that any of our components have a turnover rate that is as high as you mentioned. But, certainly turnover is a problem. One insight I have into why we have turnover is, we just had our analysts do a confidential survey for the intelligence community where it was anonymous.

What we found is that we scored very, very high on most of the variables in terms of the quality of the work, the importance of the work, but that we scored low on work/life balance. I think that is an inevitable fact of the life for an organization that does the work that we do.

I remember the chairman mentioned the issue about language skills back in 2004. We have made a concerted effort to improve the number of Arabic speakers and other relevant languages that we have. I think we have 16 Arabic speakers, and we do assign them to appropriate tasks. I would be surprised—I will go back and check, but I would be surprised—if we have people who are fluent

Arabic speakers working on Cuba issues. But rather than say that definitively, I will check for you, Senator Grassley.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Salazar, you are next.

Senator SALAZAR. Thank you very much, Chairman Baucus and Senator Grassley, for holding this important hearing.

To you, Mr. Levey, thank you for your leadership. Congratulations also on the high rating that you did receive from the 9/11 Commission, which I think did great work for this country.

I have a couple of questions for you. First, with respect to the money that is coming in that is helping kill our soldiers in Iraq. My two questions are: where is that money coming from, killing our soldiers on the streets of Baghdad and other places in Iraq, that is financing the IEDs? Second of all, what is the role of the Iranian Central Bank in terms of contributing to financing the violence against American troops in Iraq? During our break, we reached the 4,000th soldier killed in Iraq. I think these are important questions to know. Where is the money coming from that is financing the war against us there?

Mr. LEVEY. Well, thank you, Senator Salazar. The problem that we face in Iraq is, of course, a difficult one. There are many factors to fomenting violence in Iraq. It is not just one source. There are different sources funding different aspects of the insurgency and others engaging in violence.

We have, in order to try to understand this better, worked with the Department of Defense. We have actually deployed analysts into Iraq, and we set up an Iraq Threat Finance Cell that we formed in 2005. We put people in Iraq to work with the military to make sure that they are getting all of the information and analysis that they can use to understand the financial networks and the various threats that they face, whether it be Shiite or Sunni violence.

What we found, as I am hinting at, is there are a number of different sources. Some of the violence is self-funded from within Iraq from—

Senator SALAZAR. Let me ask you more precisely, Mr. Levey. A week or so ago, the IED that killed four soldiers took us to 4,000 Americans killed in action in Iraq. Do you, through your financial capabilities, have the capability to trace where the money came from that financed that particular IED?

Mr. LEVEY. I do not think that we have that kind of particularity. We do know that these IEDs are coming from Iran. Tracing the money may be a slightly separate question. We have, as I think you know, designated, for example, the KUDS force for its support to terrorism, including not only what is going on in Iraq, but also their support to the Taliban and other terrorist organizations.

Senator SALAZAR. How does the money come from Iran, and what is the role of the Iranian Central Bank in terms of financing some of these IED operations?

Mr. LEVEY. The role of the Iranian Central Bank is one that we are studying. I think where I am on that is the following. We have seen the Iranian Central Bank engaged in deceptive conduct. We have seen the Iranian Central Bank be the source of money that



was sent through Bank Saderat to Hezbollah fronts in Lebanon, and we designated Bank Saderat for its role in that activity.

We have seen the Central Bank of Iran acting in ways that give us concern that they are trying to help other entities already designated at the United Nations for proliferation evade their sanctions, but I do not have the last sentence of that, which is what I think you are asking.

Senator SALAZAR. All right. Do we have a sense of the quantum, how much money is coming through the Iranian Central Bank, whether it is to foment violence in Lebanon or Iraq?

Mr. LEVEY. With respect to Lebanon, we did make public the amount of money in that case, which was, from 2001 to 2006, over \$50 million. We have an estimate that Iran provides between \$100 million and \$200 million a year to Hezbollah alone. When I say the Central Bank, that is what I am referring to. That far exceeds the amount of money that we think—

Senator SALAZAR. And do we know where that money is coming from through the Iranian Central Bank, what is the source of that money?

Mr. LEVEY. I do not have that.

Senator SALAZAR. Is it oil money?

Mr. LEVEY. Well, I do not think that there is more that I can say, Senator Salazar.

Senator SALAZAR. All right.

Now, with respect to Osama bin Laden, the attacks of 9/11/2001 happened 7 years ago. Senator Baucus asked the question about how many agents were assigned to actually tracking the financial activities there, and I think the answer was that there were two. So what are we doing now to try to track his financial activities around the country and around the world?

Mr. LEVEY. It is not just the Treasury Department. The numbers of intelligence analysts in our government that are working on Al Qaeda are very, very high. I am sure the number is classified, but it is orders of magnitude higher. Certainly our effort on it is also orders of magnitude higher than it was on 9/11.

Senator SALAZAR. My time has expired.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Next is Senator Hatch.

Senator HATCH. Thank you, Mr. Chairman. I appreciate you and Senator Grassley and your leadership of this committee, and especially having this subject, which is a very, very important subject. I personally appreciate Mr. Levey for the great work he is doing and the intelligence that he brings to this job. I think we all owe you a debt of gratitude and thanks.

But I am very concerned about a new form of terrorism. I would call it cyber-terrorism. Examples of this phenomenon can be seen in the recent coordinated attack on Estonia's government and financial computer systems. There have been multiple reports that these attacks have originated in Russia. Now, unfortunately this assault on a NATO ally seems to be only a harbinger of things to come.

So serious is the threat of cyber-terrorism that our own military has appointed an Air Force general, it has actually created a new

command headed by a four-star general, that will be tasked with protecting our military's computer and communications systems.

Now, our Nation's financial institutions' computer systems have also been attacked by organized criminal groups in Russia. These same groups are so organized that they have websites where cyber criminals and terrorists can buy, sell, and trade militia software, spamming services, packing services, and, of course, financial information.

Now, I realize this is a public forum and that some of this you may not be able to discuss. However, in general terms, what is the Treasury Department doing to stem these assaults on our financial system?

Mr. LEVEY. Well, Senator Hatch, I think you have identified a very, very important problem. In some ways, when I think of the financial networks, they are global. They do not follow geographic boundaries. The same thing is true with our cyber systems. So, it is an asymmetrical attack that we can face from a cyber attack and it is very, very important. Our financial system is part of our critical infrastructure, as I think this committee is well aware and takes very seriously.

In the Treasury Department we have an official devoted to this, the Deputy Assistant Secretary for Critical Infrastructure Protection, whom I think the committee knows, Valerie Abend, who is very, very high quality, doing an excellent job. This is an issue in which we do have a vulnerability that we need to fix. Our adversaries are targeting this vulnerability, so we need to really step up our efforts. I think, as you indicated, that is something that our whole government has realized and made a much higher priority, the Treasury Department included.

Senator HATCH. Thank you.

Now, despite the popular perception to the contrary, the Treasury Department's new strategy of directing "financial measures" against specific individuals and entities has, as you have mentioned, met with a certain level of success. As you discussed in your testimony, the effectiveness of this strategy is a result of two major factors: first, foreign governments are more prone to support actions when presented with "conduct-based cases;" and second, foreign governments do not wish their respective financial systems' reputations to be harmed by associations with illicit activity.

Now, it would appear that the Treasury Department strategy leverages globalization and mass global communications to our Nation's advantage in preventing terrorist financing. Therefore, I am curious if the prospect of entering into free trade agreements, especially in the Middle East, has had a positive effect on the level of cooperation between nations under consideration for FTA and the Office of Terrorism and Financial Intelligence. You might even mention the effect of having it in Colombia, should we pass that free trade agreement.

Mr. LEVEY. My instinct, of course, is to say, yes, that is true. We have seen, as we develop trade relationships with other countries, that cooperation builds into other areas, including this one. So the more commercial connection that we have with the governments of another country and with businesses of another country, the better we are able to get cooperation on these issues.

I would add that one of the main reasons for that, Senator Hatch, is that the private sector is part of this fight. This is not just a government-to-government thing. That is one of the things that I think I have learned over the course of my time here, that the private sector, in many ways, is much more powerful than the government in helping us solve these problems. The more we can have that kind of relationship develop, the better off we are.

Senator HATCH. Well, thank you so much. I just want to compliment you again for your service. I have been very impressed with it. I think it has been totally bipartisan, and in every way helpful to our country. As a senior member of the Senate Select Committee on Intelligence, we have watched what you are doing and we know that it is important, and we know that we want you to keep it up.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

Without making this a bouquet-tossing contest, Mr. Levey, let me also join my colleagues in the commendations for you. I sit on the Intelligence Committee, as you know, and we get to see what you do that is classified. It is very professional work.

Let me start with your comments with respect to Iran. I share your view that getting the U.N. Security Council to adopt this resolution with respect to Iran is unquestionably a positive step, but getting individual nations to enforce the resolution will be critical.

Have the Chinese, the Russians, and the Europeans all indicated that they are going to start changing their interactions with Iran based on this resolution?

Mr. LEVEY. Well, Senator Wyden, I think you are exactly right, particularly the provision that I refer to in my testimony. A lot hangs on how people interpret it and how aggressively it is implemented.

One thing that we found that is interesting, I think, with respect to China, the private sector—to the extent it has a real private sector—is the banks in China have taken these issues quite seriously, for the reasons I indicated, which is that they want to protect their reputations and they want to make sure that they can expand to the international marketplace. So, we have seen some good cooperation there.

But a key point will be whether countries follow through. The resolution calls for vigilance on all of Iran's banks. We are looking to see how other countries follow through.

Senator WYDEN. To date, Mr. Levey, have the Russians and the Europeans done anything differently based on the resolution?

Mr. LEVEY. I do not think that the resolution has been implemented yet in other countries, but I know it is under discussion. So, I do not take that yet to be a sign of discouragement. I know that they are debating how to implement.

Senator WYDEN. So, so far China has moved with respect to their financial institutions, and it is too early to tell with the Russians and Europeans?

Mr. LEVEY. Well, the point, I think, about China, is general, about their reaction to the entire issue of the Iranian illicit activity

in the financial system and the reaction to that generally, not specifically with respect to this resolution. I just want to be clear.

Senator WYDEN. Yes. Because it seems to me that, if the big countries do not change the way they are doing business with Iran, we are still faced with very tough prospects in terms of turning around the dangerous situation with Iran. I just hope you will keep blowing the whistle on this because it is extraordinarily important.

One question, to follow up on Senator Salazar's, if I might. What is the likelihood that Treasury is going to designate the Iranian Central Bank as a financial institution involved in terrorism financing? I know you all are having a debate about it, pro or con. I would just like to get your sense on, what is the likelihood that that will happen?

Mr. LEVEY. Well, I think you would understand, that is not a question I would ever give you a very straight answer on. We do not say what we are going to do in the future.

What I will say is, I think we have been very, very aggressive and very, very vigilant about pointing out Iranian illicit conduct, particularly financial illicit conduct, and we are going to continue to do that and take whatever action we think is necessary to protect the integrity of our financial system and the international financial system.

Senator WYDEN. Let me turn if I can to Mexico, and then Saudi Arabia. You referred in your initial statement to the Merida Initiative, strengthening the Mexican government's efforts. I was just in Latin America and I am convinced that, dollar for dollar, these kinds of approaches make a lot of sense. Somehow we can go through \$10 to \$12 billion a month on the war in Iraq, and very often these kinds of investments in fighting terrorism can make a lot of sense.

How is your office you envision going to be involved in this kind of new initiative?

Mr. LEVEY. Well, I agree that it is an important initiative, and it can be quite valuable. We are already involved through outreach. There is a financial intelligence unit in the United States, FinCEN. It is sort of the major organization in my office. They have a counterpart office in Mexico, where we have already established that kind of interaction in the context of the Merida Initiative, and we are going to continue doing that. Our FinCEN director was just down in Mexico a few weeks ago.

We have seen, with the new Government of Mexico, a real commitment to working with us constructively on money laundering and drug trafficking and the like, so we hope to capitalize on that to the benefit of both countries.

Senator WYDEN. Mr. Chairman, my time is up. I have some additional questions, but why don't I wait until after you have your next round?

The CHAIRMAN. Senator, why don't you proceed? Go ahead.

Senator WYDEN. All right. Thank you very much, Mr. Chairman. And let me thank you for holding this hearing. You and I had talked a lot about this topic, and I really appreciate your leadership in this whole effort.

Let me turn to Saudi Arabia, just briefly, Mr. Levey. I know you have strong views on this, and I do as well. The 9/11 Commission

is quite critical of the role of the Saudis in terms of fighting terrorism. My own view is, the Saudis generally are much tougher about catching terrorists who are physically present in Saudi Arabia, but they are not so serious about stopping money from flowing to terrorists who are outside the country.

Now, in 2006 the Treasury Department officials reported that what the Saudis consider their financial intelligence unit was not fully functional. My sense is that maybe there have been some improvements there, and I think it would be helpful to get your sense of what is happening.

What I do not understand, frankly, is how the Saudis can continue to drag their feet on these issues when, certainly with oil selling for over \$100 a barrel, if they were serious about fighting terrorism they would put the resources into making these intelligence units “fully functional” and really an effective tool in the fight against terrorism. So, give us a sense of what is going on with the Saudis. I appreciate the good work you have been doing on it.

Mr. LEVEY. Thank you, Senator. I do think this is the kind of answer that is going to be on the one hand, and on the other hand.

Senator WYDEN. Right.

Mr. LEVEY. They are serious about fighting Al Qaeda in their kingdom, and they do. They go after the terrorists in the kingdom very aggressively. They capture them, they kill them, they wrap them up. They have had their security forces take casualties. This is a serious fight for them. We have good cooperation with them on the operational level. That does have—and I want to make sure that people understand this—a real impact on the financial networks of these terrorist organizations because they are disrupted by the actions that I have referred to.

But you are right. The seriousness of purpose with respect to the money going out of the kingdom is not as high. Saudi Arabia, today, remains the location from which more money is going to Sunni terror groups and the Taliban than from any other place in the world. I think part of this is an unwillingness to move forward on public accountability, as I mentioned in my testimony. Part of it is not being willing to invest the resources into a financial investigative capacity. What I said in 2006 about the status of their financial intelligence unit remains largely true.

I think there may have been improvements, but still, Saudi Arabia has a financial intelligence unit that has not met the criteria for admission to the Egmont Group, which is the international organization for financial intelligence units, which has over 100 members. When we think about the threat in Saudi Arabia, that is a real problem.

But I do think that the more important one is public accountability because, in the end, as I said, we can keep disrupting these networks, but, if we are going to get at it long-term, we need to stop the donors. The donor is the best way to get at them, to deter them or dissuade them in some way. The Saudis are trying to work on dissuading through statements about undermining extremist ideology, but in terms of public accountability, that remains something that they have not been willing to do.

Senator WYDEN. Well, you continue in your good work, Mr. Levey. I think, on this public accountability point, I hope that we

can continue to blow the whistle on the fact that the Saudis are foot-dragging on this question of the Charities Commission, because the point of the Charities Commission was to oversee the charitable donations and to keep them from being used to fund terrorism. Now, as far as I can tell, this commission still has not been established, and it has been years they have been dragging their feet on it. So, I hope that you will continue to hammer away at this.

I am going to assist Chairman Baucus in this area, and we will also work with you, I guess, offline on the Intelligence Committee. But I really appreciate the work that you are doing, and you have been very responsive. I may ask you some additional questions in writing as well.

Thank you very much, Mr. Chairman, for the extra time.

The CHAIRMAN. You bet. Thank you, Senator, very much.

I would like to, Mr. Levey, talk to you a little bit about the Suspicious Activity Reports, which I understand are a tool that is available to you wherein under various financial entities report large cash flows and it helps you in your efforts.

Could you describe what these are, the SARs, and also the degree to which they might be a tool that is available to this committee in some other way to get to accounts that are offshore? They are a tool that the IRS does not have available to it right now, as I understand it.

Mr. LEVEY. The IRS does have access to Suspicious Activity Reports. Every financial institution, and many others, have the obligation to report suspicious activity to FinCEN, confidential in the sense that they cannot tell their client or the underlying customer that they are making the report. Those Suspicious Activity Reports are collected by FinCEN. They are made available to law enforcement agencies, including IRS CI, and certainly many others.

The CHAIRMAN. But is it your understanding that those reports are available not only to your organization, that is, those fighting terrorism financing, but also the IRS generally?

Mr. LEVEY. I know, certainly, IRS CI.

The CHAIRMAN. Sorry?

Mr. LEVEY. I know, certainly to the Criminal Investigative section of the IRS, they are certainly available to them.

The CHAIRMAN. But what about tax evasion?

Mr. LEVEY. I think I will have to check for you in terms of whether civil tax investigators have access to Suspicious Activity Reports. I am not sure. I will have to check.

The CHAIRMAN. My understanding is that they do not, but that is irrelevant.

Mr. LEVEY. You may be right.

The CHAIRMAN. That is irrelevant. For the purposes of discussion, let us assume they do not.

Mr. LEVEY. All right.

The CHAIRMAN. How valuable do you think that tool would be?

Mr. LEVEY. That tool is quite valuable. I think what we found, from suspicious activity reporting as well as from the cash reporting that is done to FinCEN, these have been enormously valuable for law enforcement in all sorts of contexts, from mortgage fraud, which I know is on everyone's mind right now, to drug trafficking

and other financial crimes. This is a very, very rich tool that law enforcement can use as leads and to otherwise develop their cases, and certainly in terrorism cases it has been quite valuable. The FBI reports that, I think in 40 percent of their terrorism investigations, they have used either Suspicious Transaction Reporting or Cash Transaction Reporting in terms of developing those—

The CHAIRMAN. So what are the most effective tools to understand the movement of funds, transfer of funds domestically as well as internationally? This is one.

Mr. LEVEY. Well, I think the combination of this kind of reporting. All the efforts that we are making on transparency, again, in our system to make sure that—as I think you indicated earlier, we have rules for getting transparency in various parts of our financial sector.

Two things happen at the same time. First of all, bad guys figure out ways to work around it, and there is innovation for consumers, so Stored Value Cards would be a good example, that that is both useful for bad guys and useful for good guys. So what we need to do is figure out, as there are innovations, how do we make sure we get the benefit of the innovations without just giving in to the vulnerability of the innovations?

The CHAIRMAN. Let us stick with this question: what tools are best that you find most effective for you? You talked about the Suspicious Activity Reports. What else?

Mr. LEVEY. I think the Suspicious Activity Reports and the Cash Transaction Reports.

The CHAIRMAN. And what are they?

Mr. LEVEY. That is what people typically think of when you have a cash transaction of \$10,000 more, it is reported.

The CHAIRMAN. So what about these cards we are talking about, the Stored Value Cards?

Mr. LEVEY. Stored Value Cards. It is interesting. Senator, I am going to pause for a second. What we did at the end of 2005 is conduct a threat assessment on money laundering, just money laundering, and we tried to figure out, what are the different ways that all of our law enforcement agencies and regulators were seeing about how bad guys moved money. We did a comprehensive threat assessment, getting everyone's information, and we then built a money laundering strategy on top of that. So that was, I think, the first time that has ever been done.

One of the threats that we saw was Stored Value Cards; one was the trade-based money laundering that Senator Grassley talked about. With Stored Value Cards, you have—and people are familiar with it—it ranges from everything from your \$25 mall card or bookstore card to an open-ended, what we call open system cards, where they are sort of reloadable. You can keep adding value to them and you can use them in the ATM network.

So there is a range of products out there, and some of them could pose a real vulnerability on money laundering. The ones I just mentioned and what I call open-ended, I think, do pose a real vulnerability for money laundering because it is a way that the bad guys can move value without having to move cash or otherwise get access to the banking system, which is pretty tough to get access to.

So we recognize the vulnerability. The problem is, it is also incredibly convenient and useful to innocent people and we do not want to get—

The CHAIRMAN. So what are you doing about it?

Mr. LEVEY. We are trying to figure out how to regulate it.

The CHAIRMAN. What are your thoughts right now?

Mr. LEVEY. That it is going to be a difficult thing to regulate because there is no point of regulation. There are several different possibilities, ranging from the issuer to the marketer, and it is very hard and it is going to be difficult to regulate. Thus far, we have not successfully regulated.

The CHAIRMAN. So how much do you think is being transferred under the Stored Value Cards, or something similar to it on some monthly or annual basis?

Mr. LEVEY. I do not have any credible estimate for that. What I can say, and the way we have information on this, is when law enforcement catches someone and then they—

The CHAIRMAN. This is just a very convenient way to transfer cash.

Mr. LEVEY. It is.

The CHAIRMAN. That is exactly what it is.

Mr. LEVEY. It is. It is a very convenient way. It is a very convenient way. It is a way which both bad guys and a lot of good guys are using, too—frankly, probably many, many more good guys than bad guys—and we have to make sure we do not throw the baby out with the bath water, as it were.

The CHAIRMAN. Could you briefly just tell us a little bit about the role of non-bank financial institutions? For example, just last week the Federal Reserve opened a discount window to non-banks to get favorable loans. That was a whole big change in our system, which leads me to wonder the degree to which there are lots of other institutions worldwide, financial institutions worldwide, that might be involved in transferring monies that are “unregulated,” at least not as much as banks, generally. Take hedge funds, for example. There must be 1,000 different varieties and forms of financial institutions that are not banks, that are probably somehow involved that could be used in terrorism networks.

Mr. LEVEY. The general answer to that, Mr. Chairman, is that our regulations stretch well beyond banks. The requirement to have real money laundering compliance officers and file Suspicious Activity Reports and the like goes well beyond just banks to money services, businesses, et cetera, that have that obligation.

What I do not want to suggest is that it works perfectly. It does not. We have a lot of progress that we still need to make, but we are not limited to just banks in terms of our regulatory reach. The PATRIOT Act, frankly, required us to write regulations and impose these controls on a number of different industries beyond traditional financial—

The CHAIRMAN. What is your level of confidence in the degree to which you have gotten a handle on this? I mean, to be candid, just listening to you, I am not being personally critical of you. This is an incredibly complex problem. But to be candid, I get the sense that, man, we have a long ways to go yet. We are nowhere close to stopping all those flying pucks at the goalie.



Mr. LEVEY. I do not want to be flip, but I will say this. If you ever have someone sitting here saying that they know that they have it under control, then you have a problem.

The CHAIRMAN. That is right. And I did not expect to hear that from you. But what I am expecting to hear from you is some guidance as to what we can do to help make sure we have more under control.

Mr. LEVEY. Well, I think we have gotten incredible support from Congress. This started off as a real start-up with a very, very small group, and we have gotten great support. I want to say, this has been a completely bipartisan effort. We have had great support from both sides, from the House and Senate on this and we have gotten resources and we are much better off for it. But I just am not the type that would ever say that—

The CHAIRMAN. Well, I understand that. I am looking for guidance of what we have to do. Like, what about your international cooperation? Is Saudi Arabia a weak link?

Mr. LEVEY. Well, it is not just about Saudi Arabia.

The CHAIRMAN. I know that. Right.

Mr. LEVEY. I do not want to focus on that.

The CHAIRMAN. I am asking the degree to which there are other Saudi Arabias.

Mr. LEVEY. I have to say, the quote that you had, I think it was in your opening statement, that as we get further from 9/11 it is harder to keep people feeling urgent about this. Michael Jacobson, who made that quote, is someone whom I have a great deal of respect for. It is harder to keep people focused on this. It is just human nature. But I intend to stay urgent on it. The United States certainly is very urgent about this. This is a very, very high priority for us and, quite frankly, I think it means a lot. When Secretary Paulson meets with his counterparts, he always raises these issues. I think that has not always been the case for Treasury secretaries in the past. I think by doing that, he does send a very strong message.

The CHAIRMAN. Well, I know that is true because he has mentioned that to me several times. I know that. I think that is clearly very helpful.

Before I turn to Senator Kerry, though, I want you to know that, clearly, we want to do all we can to join with you and others to combat terrorism financing, so I am depending to a large degree on you to tell us, not at this hearing but at future dates, formally or informally, what you need to get the job done.

Mr. LEVEY. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kerry?

Senator KERRY. Thank you, Mr. Chairman. Thank you very much. I appreciate it.

Thank you, Secretary Levey. It is a pleasure to have you here today. I want to commend you, as others have. I think there have been public commendations of TFI's efforts to prevent the misuse of our financial system by terrorist financiers, so we appreciate that work.

This is something actually that I stumbled into a number of years ago on the Foreign Relations Committee when I was looking at the issue of the Contras and the illegal activities in Central

America. In the course of that, we found a rather remarkable network internationally of finance linked to drugs, arms, as well as ideology. It was quite an insight. I launched an investigation 20 years ago now that shut down the DCCI Bank, which, interestingly enough, not only funneled illegal funds to a lot of interesting actors who played a role in large ways, but also included Osama bin Laden back then. That was the first time that I became aware of his name.

Then in 2000, I introduced the International Counter-Money Laundering and Foreign Anti-Corruption Act, which provided the tools that you are now working with, some of them, anyway. After 9/11, I worked closely with Senator Sarbanes and Senator Levin to develop a package of anti-money laundering provisions that were included in the PATRIOT Act. So, this is an area of considerable concern.

I appreciate that your efforts are not all that well-known to everybody and not always that glamorous, but boy are they important and very, very significant in their ability to be able to reduce the easy ability of terrorists to be able to carry out their plans.

TFI has now designated some 500 individuals and entities that had been tied to terrorist activity, so that designation and the heavy premium that you have placed on financial intelligence gathering has strained their networks. On the other hand, what we have all learned through the years of working in this, like any criminal activity, the minute you begin to shut down in one place or another they begin to move to another place and develop new methods. That is what concerns me a little bit right now, is that terrorists change their methods. The question is, have we changed, and do we have the resources, and are we moving rapidly enough to stay up with them and ahead of them? That is sort of question number one, if you will.

Two, I want to know what you think we can do to adapt our tactics in response to the new ways that they raise, store, and move funds like the hawalas, for instance, and the trade-based money laundering that is taking place.

I also want to pursue just very quickly what the chairman started to ask about, which was this issue of international cooperation. After 9/11, people came to us in significant numbers and said, wow, we have to work at this, what are we going to do? There was a burst of energy. But I am concerned that that is now lagging in ways that are very dangerous to us all. There is a lack of will or there is a lack of capacity, or both, and sometimes they are intertwined.

This January, the Financial Action Task Force said that international efforts had only limited success in detecting terrorism financing activities. So, I would like to hear what you think. That is the third part of the question.

Finally, we really do know that you have scarce resources, and we are struggling with resources here in every sector of our governance now. I am pleased that there has been a shift from broad-based country sanctions to more targeted financial measures, but I get concerned when I hear that, out of the over 20 sanctioned programs administered by OFAC, more than 60 percent of investigated cases involved contraband entering from Cuba. The ques-

tion looms large whether or not OFAC and FinCEN are properly prioritizing the threats that we face and using the limited resources as effectively as possible.

So, why do we not start with those several questions on the table, and we can go from there?

Mr. LEVEY. All right. There is a lot there. Let me see if I can answer as much of it as I can, and cover as much of it as I can.

I think, let me start with international cooperation, because maybe it is the most important. As I said to the chairman, I think there is a challenge in terms of keeping people focused on this. After 9/11, this was the issue for everybody in the whole world. We are now in 2008.

Having said that, I think that the people who work on terrorist financing and money laundering issues, and particularly the Financial Action Task Force that you mentioned, Senator Kerry, they have made a huge difference. That work, I think, does continue very, very powerfully and is even adapting—to maybe pull two answers into one—to new methods. So one of the things that we have seen is that, as terrorists get pushed out of the financial system, they move to cash couriers, for example.

So what the Financial Action Task Force did is they started with recommendations about terrorist financing. We saw that that was one of the adaptations that were being made by the terrorist groups. We now have a new recommendation from the FATF about cash couriers and the kinds of controls that need to be put in place.

Senator KERRY. How long does it take you to implement when you get that kind of recommendation? How fast can you respond?

Mr. LEVEY. There are 175 countries that have pledged to implement status standards and they subject themselves to mutual evaluations. No one gets them all perfectly, including us. We had our own mutual evaluation, and we have improvements that we need to make. But what we try to do is, as you said, if there is a will, if there is political will and people want help, we try to identify training and technical assistance, including through the Treasury Department's Office of International Affairs, which provides a lot of technical assistance, as does the State Department, but also other countries.

Senator KERRY. Who is the point person on that? Who is the lead in that effort to motivate and guide those 175 countries? Is that State or is that you?

Mr. LEVEY. The FATF would be us. The FATF is a Treasury-led—

Senator KERRY. Do you feel, though, that extraneous State or DoD or White House priorities often get in the way of that, that you are not sufficiently leveraged?

Mr. LEVEY. No. I think we have gotten incredible support on our FATF work, and people are recognizing the power of it, especially as the FATF has taken up the issue of Iran and put out statements about the vulnerability that Iran poses to international financial systems. I think everyone around the world is realizing that this is something that the private sector around the world listens to, and that makes it powerful because, as I said before, they have much more of a chance of having a substantial impact than governments can.

Senator KERRY. Who have been our greatest allies in this effort? Who are the fastest to respond and the greatest help?

Mr. LEVEY. That is a difficult question.

Senator KERRY. That is why I am asking. I want to know.

Mr. LEVEY. For the most part, our cooperation on these issues is very good.

Senator KERRY. Is it as good in every country? No, obviously not.

Mr. LEVEY. Of course not. What I would have to do to answer that comprehensively is, we do a report each year about what vulnerabilities exist in countries' money laundering and terrorist financing regimes, and there are also these mutual evaluations that I referred to.

Senator KERRY. Well, are there some countries that just get it and are really rabid supporters of this effort?

Mr. LEVEY. There are and there—

Senator KERRY. Such as?

Mr. LEVEY. Our Western European allies are quite strong on these issues. They have very good controls.

Senator KERRY. I will wait until the next round.

The CHAIRMAN. Senator Wyden? Thank you, Senator.

Senator WYDEN. Thank you, Mr. Chairman.

Just very briefly, I want to follow up on Saudi Arabia, Mr. Levey. You have a talented squad of financial analysts. When you come across leads about possible terrorist financiers in Saudi Arabia, is that information passed on to the Saudi government?

Mr. LEVEY. Senator, could I take that up with you in another setting? I would be happy to, and I will do it as soon as you want, but I would rather not have that discussion in this session.

Senator WYDEN. All right. I will do that as part of my classified information handling as a member of the Intelligence Committee, because I really do want to know what happens with that information.

Mr. LEVEY. I would be happy to.

Senator WYDEN. Then the last question, very briefly. We have been outlining this morning all of the ways in which Saudi Arabia has been foot-dragging on these kinds of questions of terrorist financing. I mentioned the Charities Commission. I mentioned the fact they have been slow to put in place, as you call it, a fully functional financial intelligence unit.

In your judgment, because of the nature of the Saudi government, tackling these questions, like establishing a Charities Commission, does it really not come down to the royal family's political will? If the royal family has the political will to deal with these issues, it happens. Do you agree?

Mr. LEVEY. I agree to the extent that the things that we have asked them to do are things that they are capable of doing, but I also think that they have shown political will on other issues that are important to us, including fighting terrorism within the kingdom. So, yes, I agree that these are issues that they could tackle and have the resources to.

Senator WYDEN. It just comes down, on issue after issue—I mean, you have cited appropriately, in my view, the importance of overseeing these charitable donations. I mean, there is no question that what happens today is, when somebody goes to a gas pump

in Medford, OR, eventually a part of the price you pay for gasoline in Medford, OR makes its way to Saudi Arabia and they back-door it then through these various terrorist organizations. I would just appreciate your keeping the heat on.

Mr. LEVEY. I feel obliged to make the comment that I do not want to imply that I am saying that this is state funding of terrorism.

Senator WYDEN. Oh, no question.

Mr. LEVEY. Okay. That is Iran.

Senator WYDEN. What happened is, and this has been clear all the way from the 9/11 Commission, is that we are seeing donations from private parties make their way through these charitable endeavors, and the Charities Commission, which was supposed to be set up to oversee the donations and keep them from being used to fund terrorism, is now 3 or 4 years into the debating stages, still has not taken place.

I think what you have made clear is something I feel very strongly about, which is, while the Saudis have been willing to work in other areas, as you have just indicated, they have not had the political will to really put in place these organizations that deal with the financing of terrorism as it relates to stopping money from flowing to terrorists who are outside the country. Again, I appreciate your work, and we will talk offline about the first question I asked.

Thank you for the time, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

Mr. Levey, the Treasury IG's office has briefed us on what is potentially quite a serious example of mismanagement at TFI, and that is the failure to get up and running a computer system that connects the Treasury to other intelligence agencies. Funding has been received for this system, and the operating project was scheduled to be completed last September 30. That is my understanding, but it has still not happened. It seems to me it would be a good idea to get a pretty good computer system operating between the intelligence communities. What is the deal?

Mr. LEVEY. The deal is—and thank you for the question, this is important—we expect, in the middle of this—we are in April now, right?—in the middle of this month, to have the next stage rolled out.

The CHAIRMAN. Well, this is April Fool's Day. We are not quite there yet.

Mr. LEVEY. By mid-April.

The CHAIRMAN. All right.

Mr. LEVEY. From wherever we are now, in mid-April we expect the next phase to be deployed. It is a few months behind, no question about it, but it is still on budget and, in a broader sense, on track. This is a critical project for our success.

The CHAIRMAN. So you expect to be up and running when?

Mr. LEVEY. Middle of April.

The CHAIRMAN. In a couple weeks?

Mr. LEVEY. In a couple of weeks. Give me until the end of April to give me a little play in the joints there.

The CHAIRMAN. Good.

Mr. LEVEY. But if we are not there by the end of April, we will be up to tell you about it.

The CHAIRMAN. All right.

Senator Kerry, any questions?

Senator KERRY. Yes, I do. I appreciate that. Let me follow up.

Let me come back to what I was asking. You said the Western European countries. What about the biggest problems right now? Who are the slowest to respond?

Mr. LEVEY. I am not trying to be difficult, Senator Kerry. There are a number of countries that do not have adequate terrorist financing and money laundering laws, and some of them are more important to us than others. So, for example, it is a problem that Kuwait does not have an adequate terrorist financing law. It is not the only country that does not have a terrorist financing law, but it is important that they—

The CHAIRMAN. I do not mean to interrupt, but that is surprising to me because Kuwait is a friend.

Mr. LEVEY. It does not track in terms of friends or not friends. It is just, these are issues that it takes effort, it takes people with expertise, and it takes, oftentimes, political will. It took a long time to get a money laundering law passed in Jordan, and there is no better friend in this effort.

But we have, in Turkey, for example, where there is a big financial system, an important ally, generally trying hard on these issues, but they have a definition of terrorism in their terrorist financial money laundering laws that is limited to acts of terrorism against Turkish nationals. That is a problem because that is out of step with the international camp.

Senator KERRY. What I have found, at least, in my experience with this is, it is usually a question of interest, country interest, business interest, sometimes political and business combined. But it is always money that is at the bottom of this, as some of you know. The point I am making is, you have to make the connection between this money and the ultimate danger to these people, and a lot of them do not accept it.

I was just recently in Pakistan, and both the new leadership and others just view the insurgency differently than we do. For them, the threat is the Massoud and the indigenous insurgency, not Al Qaeda. That drives them to a different set of balances.

Mr. LEVEY. You are right, Senator. I think the point you just made, which is why I started to intervene, you are exactly right. We have to convince them that it is in their interests to do this. I think there is a good argument that it is in their interests to do this, which is that, by bringing their financial system up to international standards, they are more likely to attract investment and attract business from outside. When they are not living up to international standards, people do not want to do business with them. That is the argument that we try to make, and it is oftentimes successful, but we have to keep pushing on that issue.

Senator KERRY. Well, in Iraq, in Anbar Province, until recently—I am not sure what the status is exactly today—I know there were some 70 different export-import banks in Anbar Province that were engaged in the funding of illicit activities. They were fronts for those illicit activities. In the Shiite part of Iraq it is more depend-

ent on the hawalas as their means of movement of money. But what steps have been taken by the Government of Iraq, where we are pouring life and money at extraordinary levels to support them, to be supportive of us?

Mr. LEVEY. Well, we are working very closely with the Government of Iraq. We have people on the ground there.

Senator KERRY. Well, we know we are working closely with them. What are they doing? This is 6 or 7 years now. We are moving down the road here, and they are still a part of the problem.

Mr. LEVEY. Well, we are trying to set up a banking—this is a significant problem, Senator. I am not trying to minimize it. The problem is, we need a banking system in Iraq so that it is not so much of a cash society. A cash society has all the vulnerabilities that you are very well aware of in terms of illicit conduct.

We need to have a secure banking system so that people can move money electronically for legitimate purposes so that we do not have innocent people traveling around with lots of cash, because then it is hard to separate out the good from the bad. We are working with them on that and we are seeing some progress, but we have a ways to go.

Senator KERRY. To what degree, similarly in Afghanistan, is the narcotics trafficking, the poppy, undermining our own efforts and providing a source of funding for Al Qaeda and the Taliban and for counter-government efforts?

Mr. LEVEY. I am a little nervous about what I am allowed to say publicly. Of course, you could get a full briefing. It certainly is one of the sources of funding and control from the Taliban. It is not the only source of funding. They are also getting funds from outside, as I indicated in my answer to Senator Wyden. There are other sources of funding going into the Taliban. Frankly, the quote from Shaykh Sa'id that I had in my opening statement is him trying to raise money for the Taliban. But there is no doubt that the drug trafficking in Afghanistan contributes to it. I think it is different in different parts of Afghanistan.

Senator KERRY. Well, what about the resourcing to you? What you are describing is a major connection. This is the great facilitator of terrorism: money and its movement. To the degree that we have transparency and accountability, obviously everybody is better off, not to mention just in governance in terms of who is making what money where, and the flow of capital.

So this has always struck me as an area that just gets overlooked. Somehow we are willing to send people in uniform to put their lives on the line, we put billions of dollars into the jets and the bombs and this and that, but if you cannot deal with these kinds of issues you are not putting your priority where it ought to be.

What do you need to augment this effort and to give it the full measure of light that it deserves?

Mr. LEVEY. Well, I like the question, Senator Kerry. I appreciate it. I think we have gotten a lot of support. We have had our budget fully funded each year, and it has increased each year. I do not think it is necessarily the case that every government official sitting here would always say, I need more resources. You could make

the argument for more resources, but the truth is, it is more about using our resources wisely.

I think we have adjusted in response to some of the chairman's concerns, and making sure that we continue to raise this at a high level politically, because it is not so much needing more people, it is making sure that we make this a priority in our relationships with other governments and making it a priority when we deal with the private sector leaders in other countries.

To get to your point, I think one of the best sources of getting political will generated in some of these countries to improve their systems of controls on these issues is the private sector, because they are trying to live up to the international standards themselves because they want to do business internationally. They sometimes go to their own governments and say, hey, let us improve our law. So it is more a question of using our resources wisely, making sure we are talking to the right people, and continuing to keep it high on our political agenda.

Senator KERRY. Well, with all due respect, I have to say to you, I mean, I realize the position that any leader of an agency is in with respect to defending the budget up here. After the years I have been here, I am sort of impatient with the automatic defense that you get and lack of reality sometimes.

I have to tell you, having just been in both Pakistan and Afghanistan, it is shocking to me the disparity between the amount of money going in there. I think it is a half a billion that was going into Pakistan, compared to \$10 billion, \$12 billion a month—half a billion a year, compared to \$10 or \$12 billion. That is the center of the front on terror. That is where Al Qaeda is. That is where they have reconstituted in some 60 countries today.

I have had that intelligence briefing, and I really am not satisfied that we are doing what is necessary to build the infrastructure. The Karzai government is locked into Kabbul fundamentally. They have huge problems getting out to the rest of the country, where 70 percent of the population is. Unless we resource that adequately, both militarily and otherwise, we are going to fail there. That is what most experts who have been there, from General Jim Jones and others to the current folks who are there, tell us. So, I do not think it is adequately resourced.

I think you deserve to have more ability to be able to leverage these countries and to put people in them to provide the technical expertise and to help provide even some of the technology and the hardware and the training, and that is labor-intensive. So, I thank you for the work you are doing, and I understand you are doing well with the limits you have. But this has to get actually a much higher priority, in my judgment.

Mr. Chairman, thank you for having this hearing. I think it is very important. I appreciate the time.

The CHAIRMAN. Thank you very much, Senator.

A couple of matters here. On behalf of Senator Grassley, I would like to put in the record a testimony of former CIA Customs Agent John Cassara. That will be in the record.

[The prepared statement of Mr. Cassara appears in the appendix.]



The CHAIRMAN. Second, I would like to place in the record a July 3, 2007 letter from Acting IRS Commissioner Kevin Brown. It is a letter to the chairman on the issue of how the IRS checks names on nonprofit tax filings against terrorist watch lists.

[The letter appears in the appendix on p. 31.]

The CHAIRMAN. Finally, Senator Grassley and I also have learned that we should ask the Government Accountability Office to conduct a comprehensive review of the Office of Terrorism and Financial Intelligence, and we are sending a letter with that request today. I think we agree that, after 4 years and to prepare a new administration for its anti-terrorism financing duties, that this sort of study could be very timely.

I want to thank you again, Mr. Levey, for your testimony today. I generally believe and feel, as others have stated, that you are doing a pretty good job, given the resources that you have and given the degree to which this is or is not a priority for the entire administration. I frankly believe it should be a higher priority, a much higher priority. I hope that you are able to be very effective in convincing the administration to put this up several notches.

There are lots of, I know, different offsetting interests that the administration has with all these different countries, but frankly, the bottom line to me is terrorism and making sure that we do snuff out the financing of terrorism. It comes down to money, as you have often said, and I just hope very much that we get this to a much higher priority. It is a higher priority now, but in my view it must be a still higher priority. I hope we can accomplish that objective quickly.

Thank you very much. The hearing is adjourned.

[Whereupon, at 11:40 a.m., the hearing was concluded.]



# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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### SUBMITTED BY SENATOR BAUCUS



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D. C. 20224

July 3, 2007

The Honorable Max Baucus  
Chairman, Committee on Finance  
United States Senate  
Washington, DC 20510

Dear Mr. Chairman:

Secretary Paulson has asked me to respond to your letter to him dated May 25, 2007, concerning the recent report of the Treasury Inspector General for Tax Administration (TIGTA) on anti-terrorism screening of exempt organizations.

The TIGTA report addressed the screening process performed by the IRS's Tax Exempt and Government Entities (TE/GE) business unit. In this process, employees match names on applications for tax-exempt status (Forms 1023) and on annual information returns filed by exempt organizations (Forms 990) with names of Specially Designated Nationals (including designated terrorists) on a list compiled by the Department of the Treasury's Office of Foreign Assets Control sanction programs (OFAC list).

We described this screening process and our use of the OFAC list in response to a previous request. In 2004, the Committee asked for documents pertaining to certain exempt organizations suspected of having terrorist connections. We provided the requested information and met with Committee staff to review the documents and discuss our anti-terrorism program. I am enclosing a copy of our letter dated March 4, 2004, for reference. We are pleased to have this opportunity to provide additional information about our screening process.

The screening process performed by TE/GE is one part of a much broader anti-terrorism program at the IRS. The IRS Criminal Investigation (IRS-CI) Division has the leadership role within IRS for investigating and supporting the prosecution of terrorists and their financial backers. It is supported on the civil side by TE/GE.

The IRS-CI Division works closely with the Department of Justice Counterterrorism Section (DOJ-CTS) and the Federal Bureau of Investigation (FBI) Terrorism Financing Section (TFOS) to target tax-exempt organizations and non-governmental organizations. The FBI is the primary investigative law enforcement agency for all terrorism investigations. It has unique authorities and investigative tools that no other law enforcement agency possesses, and it is a full member of the intelligence community. The FBI's Joint Terrorism Task Forces (JTTFs) are the primary mechanism for local, state, and federal joint investigative efforts on terrorism cases. The IRS-CI Division supports the FBI's efforts through participation on the JTTFs and the National Joint Terrorism Task Force at the National Counterterrorism Center.

Even before September 11, 2001, IRS-CI special agents were actively involved with anti-terrorist efforts and participated in the existing JTTFs. Immediately following the tragedy, IRS-CI increased its participation on the FBI's expanded JTTFs. Consequently, IRS-CI participates in every major terrorist financing investigation.

The IRS-CI Division also supports a multi-agency initiative to investigate and prosecute individuals and charities associated with terrorism. This initiative - the Non-Governmental Organizations Charity Task Force - leverages resources and optimizes the sharing of critical information possessed by the law enforcement, intelligence, military, and diplomatic communities. Our TE/GE Division has been an active participant in this taskforce since its inception.

Generally, legal prohibitions regarding the disclosure of tax information restrict our ability to share information with other law enforcement agencies. The IRS-CI Division therefore established the Garden City Lead Development Center (GC-LDC) to focus on terrorist financing cases by using tax information to develop leads on terrorist organizations. The IRS-CI Division shares these leads with other law enforcement agencies while abiding by the restrictions on unauthorized disclosures. Our TE/GE Division provides resource support to the GC-LDC.

The TE/GE screening program, in which IRS employees review names on applications for exemption and on exempt organization annual information returns, serves as a backstop to the IRS's primary anti-terrorism efforts and provides an additional level of assurance.

While we agree with TIGTA that TE/GE's manual system is not ideal, it remains a meaningful tool. A determination specialist reviews every line on every Form 1023; checking the OFAC list is one of a series of tasks the specialist performs in this review. We also manually check each Form 990 as it arrives. While we do not want to overstate the utility of these reviews, we do achieve matches with names on the OFAC list through this process, as TIGTA has noted.

The TIGTA made two recommendations in its report. First, TIGTA recommended that we computerize our list-checking procedures. We have been actively pursuing this goal, and we agree with this recommendation. Second, TIGTA recommended that we evaluate the use of additional terrorist watch lists, including the list compiled by the Terrorist Screening Center (TSC list). We also agree with this recommendation.

With that as background, let me answer your specific questions:

**1. Why does the IRS use the OFAC list of suspected terrorists instead of the more comprehensive list kept by the Terrorist Screening Center?**

We need to use a terrorist watch list in our screening program that will provide actionable information with a minimum of false matches. While we are very willing to

evaluate the usefulness of other watch lists, we have used the OFAC list in our screening program because its origin, its characteristics, and its reliability seem to us to be well-suited to that need.

The OFAC list (more formally referred to as the Specially Designated Nationals (SDN) list) is made up, in relevant part, of individuals and entities subject to economic sanctions because they have been designated under authority of statute or Executive Order as terrorists or supporters of terrorism. An organization may be designated on OFAC's SDN list as a Specially Designated Global Terrorist (SDGT), Specially Designated Terrorist (SDT), or Foreign Terrorist Organization (FTO). (The OFAC list also contains the names of individuals and entities subject to economic sanctions pursuant to other sanctions programs administered by OFAC, including designated narco-traffickers, weapons of mass destruction proliferators, and others.)

Although the TSC list is much larger than the OFAC list (in part because the standards for inclusion are lower), it is not self-evident that this makes the TSC list superior to the OFAC list for the purpose of an effective screening program. While data on both the OFAC and TSC lists can be based on classified information, the OFAC data undergoes a thorough, multi-agency review that concludes with a finding by the Director of OFAC that the individual or entity should be placed on the list. This process increases the likelihood of an actionable match and reduces the likelihood of a false match. A false match does not contribute to national security. It wastes time and resources, burdens the Form 990 and the Form 1023 processes, and has the potential to impugn the reputation of an individual or an organization wrongly identified. We are committed to using a list or lists that will allow us to select the right organizations and individuals for additional scrutiny.

That said, we appreciate and accept TIGTA's recommendation that we evaluate the TSC list. We began our evaluation of the TSC list in May.

In evaluating the TSC or other lists, we consider several factors. How and why are people or organizations designated for inclusion on the list? What probative value does the list have, i.e., will the courts sustain an action we have taken with respect to an organization's tax-exempt status based on the organization's placement on a terrorist watch list? How much identifying and other information is available behind the listing, and is that information available to the IRS? What barriers or restrictions exist that might constrain the IRS's use of the data? Can the list be accessed effectively by name-matching software?

**2. Why are IRS personnel screening potential terrorist financiers by looking for people with "Middle Eastern sounding names"? What directives have IRS personnel received from the IRS Tax Exempt and Government Entities Division on how to determine whether to flag a person or organization named in a Form 990 or Form 1023 for terrorist ties? Does the Division have written policies for screeners to use to determine whether a person or organization deserves further**

**scrutiny? If so, please provide these documents.**

The TIGTA report does not state or imply that TE/GE screeners select individuals or organizations for additional scrutiny on the basis of a Middle Eastern sounding name. It is not IRS policy for our employees to do so. I am enclosing the portion of the Internal Revenue Manual and the instructions TE/GE has issued to its agents that govern this review. Please note that we have issued no directive or instruction advising employees to use the presence of a Middle Eastern sounding name as a basis for screening.

We instructed our employees to check Forms 990 or 1023 against names that appear on a spreadsheet that TE/GE produces and regularly updates. The names on the spreadsheet come from the OFAC list. We exclude from the spreadsheet names and addresses from the OFAC list that are unrelated to terrorism (e.g., those related to drug dealing), and we have added a few names and addresses at the request of IRS-CI. We expect our employees who review the Forms 990 and 1023 to be familiar with this spreadsheet, and we have taken this opportunity to reiterate to our screeners that they are to adhere to established screening procedures. I am enclosing a copy of the spreadsheet, redacted to exclude a small number of names and addresses related to criminal investigations.

**3. In response to the TIGTA report, the IRS agreed to develop a strategy to automate the checking of names by December 31, 2008. If the Tax Exempt and Government Entities Division has been testing automated systems since 2004, as the IRS claims, why would it need more than a year to develop a strategy for automating the system? What progress has the agency made since 2004 on this project?**

The December 31, 2008, date is our estimate of a realistic outside date by which we will have completed the actions we agreed to take to implement TIGTA's recommendations. This date is not as early as any of us would like, and we hope to complete our work ahead of it.

To do so, we need to overcome a number of barriers. We must evaluate possible watch lists, including the TSC list. The technical characteristics of a list we select will influence how we are able to access it electronically. We must find and test an effective search engine (those tested to date have not performed well), and ensure that we can conduct our searches in a secure environment. Most importantly, we must find a way to make information submitted on Forms 990 and 1023 searchable electronically, including the names of donors on Schedule B to the Form 990.

The vast majority of exempt organizations still file paper returns rather than electronic returns. We require larger exempt organizations to file their annual Forms 990 electronically, but section 6011(e) of the Code prevents us from requiring electronic filing unless an organization files at least 250 returns annually. The Administration's 2008 budget request again asks that section 6011(e) be amended to lower this

electronic filing threshold. We support this proposal as a much-needed step that will facilitate numerous automation goals, including an improved ability to search returns for names connected with terrorism.

Our recent work with the Terrorist Screening Center has given us some reason to think that we may be able to move more quickly than we expected to evaluate the TSC list and to access an effective search engine in a secure environment. But even if we rapidly accomplish these goals, we will still need to continue our work to make the Forms 990 and 1023 data searchable.

**4. Please explain in a timeline the steps taken to put in place an automated system for checking names associated with nonprofits from September 11, 2001 to June 1, 2007. Also, please explain why it will take the Treasury Department over seven years since 9/11 just to develop a strategy to put in place an automated system?**

We have prepared the enclosed timeline titled "Year-by-Year Timeline of IRS EO [Exempt Organizations] Automation Steps Relevant to Terrorist List Screening."

As the timeline demonstrates, we have been pursuing a strategy to automate the process of checking information from Forms 990 and 1023 against terrorist watch lists for some time and have put in place interim manual procedures. As stated in our answer to question 3, the strategy involves three elements. First, evaluate additional watch lists. Second, find and test an effective search engine and ensure that it will be used in a secure environment. Third, find a way to make more information on the Forms 990 and 1023 searchable.

We are making progress in each of these areas. We are evaluating the TSC list. We are testing search engines. And we are addressing, through a number of alternatives, how to increase electronic filings and how to make paper filings electronically searchable.

We have successfully rolled out an electronic filing capability for the Form 990 series for all who wish to use it. We continue to push for wider mandatory electronic filing, and we have asked for your help to accomplish this. We are considering ways to use a limited amount of Form 990 data we purchase from a vendor. Although this data is nominally searchable, at present it is inadequate for the terrorist screening process. We have experimented with intelligent imaging of Forms 990 and 1023. Soon we will roll out 2-D bar coding for the Form 1023. This will place all information from that form on bar codes where we can image it or search it by machine. We are pursuing these alternatives because we will not be able to conduct computer matching of names against terrorist watch lists until data from Forms 990 and 1023 is available in an electronically searchable format.

**5. When is a fully automated system expected to be in place at the IRS?**

After development of the strategy within the timeframes agreed to with TIGTA, we expect to have an improved and more automated system in place no later than December 2009. Some parts of the system should be in place prior to that date. As these parts come on line, they will improve the present screening process. We caution, however, that without electronic filing and a sufficient budget, we may not be able to fully automate our screening processes in the immediate future.

**6. Treasury's Office of Terrorism and Financial Intelligence (TFI) has been operating for over three years. What effort did the TFI make to monitor this situation at the IRS and what changes were demanded by TFI to improve the matching of tax forms from nonprofits and terrorist watch lists?**

The Office of Terrorism and Financial Intelligence (TFI) has provided the following answer to question 6:

*The twin aims of TFI's mission are to safeguard the U.S. financial system against illicit use and to counter national security threats such as the financing of terrorism and WMD proliferation using a variety of regulatory, law enforcement and intelligence authorities. Within TFI, the Office of Terrorist Financing and Financial Crimes (TFFC) works across the interagency community, with counterparts from other finance ministries, international standard-setting bodies such as the Financial Action Task Force (FATF), and the private sector to develop policies that ensure effective adoption and implementation of anti-money laundering/counter-terrorism financing measures and controls, including targeted economic sanctions.*

*In terms of protecting charitable giving from terrorist exploitation, TFFC has worked with the interagency, international and private sector communities to develop and implement the following five-pronged national and international strategy:*

- (i) develop typologies of terrorist abuse of the charitable sector to promote a greater understanding of this threat;*
- (ii) improve transparency of the charitable sector through greater oversight;*
- (iii) target and coordinate enforcement actions against charities engaged in terrorist financing;*
- (iv) conduct outreach to the charitable sector and vulnerable donor communities to enhance awareness of the threat and enlist support for governmental and private sector efforts to combat this threat; and*
- (v) engage the international community to address the threat on a global basis.*



*In implementing this strategy, TFFC has worked with its partners to develop a variety of products and launch a number of initiatives, including:*

- *leading the development and publication of international typologies of terrorist abuse of the charitable sector through the FATF typologies process;*
- *facilitating greater transparency across the U.S. charitable sector by promoting greater federal, state and private sector oversight;*
- *publishing and maintaining a summary of charitable organizations and fronts designated for engaging in terrorist financing;*
- *issuing the "Updated Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities"(Guidelines), which describes protective measures that charities can adopt to minimize the risk of abuse or exploitation by terrorist organizations; and*
- *leading the development of an international standard under the FATF Special Recommendations on Terrorist Financing that incorporates the five-pronged strategy outlined above.*

*These and other products and initiatives to combat terrorist exploitation of the charitable sector are available and described in greater detail on the Treasury website at <http://www.treas.gov/offices/enforcement/key-issues/protecting/index.shtml>.*

*TFI did not participate in the IRS's internal decision to institute procedures to check names on Forms 1023 and 990 against the Specially Designated Nationals List ("SDN") administered by OFAC, and does not exercise direct operational oversight over such matters. However, TFI was supportive of IRS's decision to institute checking procedures and concurs with TE/GE's current plans to adopt automated procedures. Along these same lines, TFI frequently consults with IRS-TEGE on related issues, including the development and publication of "typologies" of terrorist exploitation of charities and other guidance materials. Additionally, TFFC staff works with IRS-TEGE in coordinating direct outreach to both the charitable sector and Arab-American and Muslim communities.*

*In conclusion, TE/GE implemented the list-checking processes that are the subject of TIGTA's report as one part of our overall and much broader anti-terrorist effort. We are working to improve TE/GE's processes by evaluating the TSC watch list and by developing an automated system that will allow us to search Form 990 and 1023 data effectively and efficiently. We remain committed to doing whatever we can to ensure the safety of Americans.*

I hope this information is helpful. If you have any questions or concerns, please call me or contact Steven T. Miller, Commissioner, Tax Exempt and Government Entities Division, at (202) 283-2500.

Sincerely,

A handwritten signature in black ink, appearing to read "Kevin M. Brown".

Kevin M. Brown  
Acting Commissioner

Enclosures (11)

## **The Stalled War on Terrorist Finance**

**Statement to the  
Senate Finance Committee  
April 1, 2008**

John A. Cassara

Without money, there is no terrorism.

It is an axiom in the U.S. intelligence, law enforcement and military communities that successfully following the money trail in the War on Terrorism is potentially more important than any tactical battlefield victory. However, a few years ago I spoke with a South Asian businessman with ties to underworld finance. In a damning statement about our efforts on the War on Terrorism's financial front he told me, "Don't you now that the terrorists are moving money and value right under your noses? But the West doesn't see it. Your enemies are laughing at you."

In 2005, I retired after a 26 year career as a Case Officer for the Central Intelligence Agency and as a Special Agent for the U.S. Department of Treasury. My final assignment was in the Department of Treasury's Office of Terrorism and Financial Intelligence (TFI). I have tremendous respect for TFI and Under Secretary Stuart Levey. In today's testimony, Under Secretary Levey is correct noting that we have had some success in on our War on Terror Finance. We also have many challenges ahead of us. In large part this is because we have spent an enormous amount of time and resources attempting to follow the terror finance trail in many of the wrong places and emphasizing

tactics and countermeasures that were developed for previous conflicts. Because I feel passionately about the importance of “following the money” in combating terrorism, I wrote a book, *Hide & Seek – Intelligence, Law Enforcement and the Stalled War on Terror Finance*; Potomac Books, 2006. The following are a number of observations and facts in our War on Terror Finance that have been largely ignored.

Shortly after the most successful terrorist attack in history, a Pakistani journalist located Osama bin Laden in the mountains of Afghanistan. Bin Laden was asked if he was afraid the West would move to identify and seize al Qaeda’s assets. He was quoted as saying that attempts to find and freeze such assets “. . . will not make any difference to al Qaeda or other jihad groups. Al Qaeda is comprised of modern, educated young people who are as aware of the cracks in the western financial system as they are of the lines in their own hands. These are the very flaws in the western financial systems which are becoming a noose for it.” The funding for September 11 and other terror attacks worldwide demonstrate that al Qaeda has identified many of those flaws.

Unfortunately, as has happened repeatedly throughout history, decision makers initially persist in fighting new wars using tactics and procedures developed for previous conflicts. In the new War on Terror Finance, our bureaucracies and decision makers insisted that the Bank Secrecy Act’s financial transparency reporting requirements and sanctions and designations would be our primary financial countermeasures. The results have been disappointing.

After September 11, financial investigations confirmed that the terrorists identified the “cracks.” The operation cost al Qaeda approximately \$300,000-\$500,000. None of the tens of millions of financial transparency forms filed in the U.S. or the countless millions of similar forms filed overseas captured the movement of funds to finance the attacks by the 19 hijackers. Moreover, in subsequent terrorist attacks from Bali to Baghdad, financial intelligence reports filed primarily by financial institutions and money service businesses have not proved particularly helpful. Simply put, terrorists use inconspicuous amounts of money in ways that do not trigger the financial reporting requirements that were designed primarily for the large amounts of money laundered in the War on Drugs.

Why the emphasis on outdated countermeasures such as those that were developed during the War on Drugs and the Cold War? After September 11, I watched as entrenched managers and government bureaucracies moved to preserve their turf, vested interests, reputations, and budgets. For example, Treasury’s Financial Crimes Enforcement Network (FinCEN) was reluctant to look past the BSA data it was mandated to analyze and regulate.

FinCEN should be the U.S. government’s premier financial crimes resource.

Unfortunately, it has never lived up to its early promise and potential. Annually, FinCEN receives approximately 18 million financial intelligence reports, including about one million Suspicious Activity Reports (SARs). Yet FinCEN’s attempts to systematically analyze this massive amount of financial intelligence have been disappointing. For example, repeated attempts at “data mining” financial intelligence including the

successive “Artificial Intelligence,” “Component Analytical System,” and “BSA Direct” programs have all failed. The combined monetary cost of these failures is in the multi-tens of millions of dollars but the real cost is the waste of precious time while we are fighting the War on Terror. (FinCEN management was never held accountable for the repeated failures.)

There is now serious discussion about FinCEN receiving cross-border wire transfer data from financial institutions. If FinCEN cannot analyze 18 million financial intelligence reports a year, what in FinCEN’s track record suggests that it will be able to efficiently process and analyze exponentially more information?

Moreover, FinCEN only dedicates a very small number of analysts to “pro-actively” examine SAR filings for criminal purposes. And management has told the analysts to only examine SARs that are linked to terror finance. How does one know that other forms of suspicious activity are not possibly linked to terror? And if in the course of reviewing SARs for terrorism, if the analysts find unrelated signs of criminal activity that should be brought to the attention of law enforcement the information is ignored. The bottom line is that pro-active analysis of financial intelligence at FinCEN is extremely weak for law enforcement – as opposed to regulatory – purposes.

Today, FinCEN believes that it can best serve law enforcement by “empowering” state, local, and other federal agencies by granting them access to BSA information and letting them do their own financial analysis. However, the results have also been mixed. As

noted, FinCEN's attempt at establishing "BSA Direct" failed and its Project Gateway that grants access to BSA data has changed little from the mid-1990s. I have spent a lot of time over the last two years teaching state and local law enforcement about money laundering and terrorist finance and I know first hand that there is a continued need for access to BSA financial intelligence that is not being currently met. Meaningful "strategic analysis" and insight into new money laundering and terror finance methodologies are also in short supply. Perhaps this is because FinCEN suffers a continuing "brain drain" and a hemorrhage of expertise. It has also suffered a revolving door syndrome of departing directors.

Financial institutions and money service businesses spend enormous amounts of money and resources complying with government mandated financial reporting requirements. The industry would be shocked to learn the true extent of the under utilization of their reports. There is a growing movement to subject a long list of "dealers" to financial-transparency reporting requirements. Although I have seen first-hand the utility of financial intelligence, before we propose additional regulations and the commensurate reporting requirements, we should insist that the current data is properly exploited.

When FinCEN was originally created, its mission was to "support law enforcement." Moving away from that mission, FinCEN has now turned itself into more of a regulatory agency. The results are also mixed. For example, the United States currently has few safeguards against abuse of "new payment methods" (NPMs) sometimes also called e-money, digital cash, or m-payments. NPM service providers in the United States are classified as money service businesses and, in theory, must register with FinCEN. (Most small-scale money service

businesses do not comply with registration requirements and there is little enforcement of the regulations.)

The NPM issue is briefly mentioned in the 2007 U.S. National Money Laundering Strategy: “FinCEN, in coordination with the federal banking regulators and the industry, will issue guidance and develop regulatory definitions and requirements under the BSA for stored value products and payment systems.” Unfortunately, there has been little progress in formulating and disseminating guidance and our traditional money laundering countermeasures are not adequate to address the looming threat posed by abuse of m-payments to today’s e-banking and cashless system. In my opinion, we must begin to take action soon on the NPM front. A true partnership will be required between regulators, industry, and law enforcement.

In addition to our over reliance on BSA reporting requirements to combat terror finance, there has also been a misplaced emphasis on financial blocking orders and designations.

By the end of December 2001, the United States, acting in concert with the United Nations, was able to document the freezing of \$112 million of terrorist assets around the world. This money was primarily “fruit of the low-hanging tree,” or easy pickings. By 2005, the Department of Treasury reported that 47 countries worldwide have frozen a total of approximately \$150,000,000 of terrorist assets since September 11. Of that amount only \$64,600,000 has been seized, a figure that has remained virtually unchanged since 2002. In the global contest of hide and seek, we have been spending an inordinate amount of time and resources looking in many of the wrong places. Using the government’s own benchmarks, the numbers by themselves demonstrate the War on



Terrorism Finance is stalled. Perhaps that is why the Department of Treasury, despite numerous requests, would not forward current freezing and seizure statistics to the Department of State in preparation for the congressionally mandated 2007 International Narcotics Control Strategy Report – Volume II on Money Laundering and Financial Crimes.

Slowly recognizing that the financial “measureables” are not favorable and that there has been a paucity of successful investigations and prosecutions, some observers and policy makers say that the numbers do not matter. They argue that our efforts have forced the terrorist financiers to use cash and underground financial systems such as hawala to escape the international financial transparency reporting network. However, I witnessed the use of bulk cash and indigenous, culturally unique methods of money and value transfer in areas where our adversaries operate long before September 11. They are still being used. And current countermeasures and regulatory “solutions” that lack enforcement are powerless to stop them.

“Smart” sanctions and designations are increasingly attractive to policymakers, particularly in the stalled War on Terrorist Finance. As former Treasury Secretary John Snow noted: “When the U.S. is confronted with a threat that is unreceptive to diplomatic outreach and when military action is not an option, [financial] tools are often the best authorities available to exert pressure and to wield a tangible impact.”

Weapons have, however, been known to backfire. Sometimes the rule of unintended consequences comes into play. For example, some believe that the sanctions imposed on the former regime of Saddam Hussein led directly to present day Iraq's systematic corruption, entrenched smuggling networks, and underground finance. Today, the break down of law and order and crime for profit directly fuels the terrorists and civil strife.

Last year I was in Belgrade discussing corruption with Serbian officials. They emphasized that the same sanctions that helped bring Slobodan Milosevic to Dayton hurt the common people the most. Similar to Iraq, the Serb officials told me that criminal groups were apparently the biggest winners, thriving in a corrupt environment fostered by sanctions. Fraud and smuggling networks do not simply disappear when embargoes and sanctions are removed or the conflict ends. Organized criminal networks and the vested interests that bolster them become entrenched. Embargoes often encourage smuggling, an efficient network of front companies, money laundering, underground finance, and tremendous profits for those involved in the black market. Law enforcement has seen time and again that whenever a regulatory barrier is put up, the unscrupulous will circumvent it. Additionally, sanctions often have the unfortunate side-effect of forcing previously monitored activity underground. We should remember this lesson when there are political cries to use increasingly stringent sanctions and designations against Iran.

It also took far too long for analysts and decision makers to understand the basic principle that terrorists, like money launderers, like private investors, *diversify*. In this new war, the dirty money is not going to be found in the proverbial Swiss bank account. As

bin Laden said, our jihadist adversaries are smart and know the value of spreading risk. They also use “systems” or investment and finance strategies that they are familiar with. In contrast, at FinCEN during the years surrounding September 11, upper management was fixated on western style financial institutions and BSA data and literally prohibited staff from examining indigenous and ethnic-based alternative remittance “systems” common in areas where our enemies are found.

Underground banking sometimes also known as “alternative remittance systems” or “informal value transfer systems” has many variables. Underground financial systems are almost all based on trust and are common among family, ethnic, tribal, and clan groups. Systems such as hawala are sophisticated, efficient, and effective. There is little or no paper trail for western criminal investigators to follow. They evade BSA reporting requirements in this country and financial transparency countermeasures around the world. Culturally and historically, most of the informal systems use trade to provide “counter valuation” or a means to balance the books.

Any commodity can be used in trade-based money laundering and value transfer including gold, natural gas, textiles, toiletries, electronics, foodstuffs, etc. A very simple method of money laundering via trade is over invoicing. For example, if a shipping container of electronics is worth \$50,000, but is over-invoiced for \$100,000, the subsequent payment of \$100,000 will cover both the legitimate cost of the merchandise (\$50,000) and allow an extra \$50,000 to be remitted or laundered. The business transaction and accompanying documentation disguise the illicit transfer of \$50,000, and

washes the money clean. This type of fraudulent trade and money laundering is very effective and found around the world. In fact, some academics studying U.S. trade data have estimated that up to 70% of the money laundered in the United States takes place via trade. (It is estimated we are also losing billions of dollars in lost customs revenues but we do not know for certain because we have never systematically examined the problem).

Barter trade is also effective in laundering and terrorist finance. In certain areas of Afghanistan and Pakistan, the going rate for a kilo of heroin is a color television set. Afghan drug lords exchange narcotics for stolen European cars that often are brought into the country through Iran. In South Africa, diamonds are exchanged for the synthetic drug mandrax. In Pakistan, religious schools known as madrassas have laundered cash donations via over-invoicing animal hides. The proceeds were then given to jihadist groups. These types of transactions are obviously not captured by financial transparency reporting requirements that have been our primary countermeasure. They are examples of what bin Laden called "cracks" in the western financial system and off our financial radar screens.

In 2003, I successfully introduced the concept of "Trade Transparency Units" (TTUs). Seeking to exploit the "back-door" of trade, the concept was designed to examine trade anomalies that may be indicative of money laundering, underground finance, or perhaps even terrorist finance. In an excellent example of interagency cooperation, the TTU initiative was backed by the Departments of Treasury, State, and Homeland Security.

Prototype TTUs are now being developed overseas. TTUs are an “imaginative” initiative in counter terror finance and one that deserves continuing Congressional support and funding.

Other indigenous financial “systems” employed by our adversaries includes the use of gold. For example, in May 2004, in one of the very few public pronouncements by al Qaeda about finance, Osama bin Laden himself offered a reward for killing coalition forces’ commanders. The reward was offered in gold. In 2005, cartoons of the prophet Muhammad were printed in a Danish newspaper. The resulting publicity caused outrage in the Muslim world. In February, 2006 the Taliban offered 100 kilograms of gold to anyone who killed the individuals responsible for the “blasphemous” cartoons. Why are terrorists attracted to gold?

Due to its unique properties, gold can act both as a commodity and as a defacto bearer instrument. Historically, gold has been the commodity of choice in balancing the books in hawala transactions. In Arabia and South Asia, gold is an intrinsic part of the cultures. Gold is part of the way of life and a way of doing business. Traditionally, calculating wealth in Zakat – charitable contributions and one of the five pillars of Islam – has been based on gold. However, both before and after September 11, senior management at Treasury’s FinCEN actually imposed a gag order on any discussion involving gold. How can we win a war if facts and ideas are censored? Similarly, those that tried to talk about hawala and trade-based money laundering at Treasury’s FinCEN were discredited and chased away. As a result, in the months and years after September 11, valuable time was

lost in the War on Terrorism Finance as the bureaucracies debated and struggled to adopt common frames of reference in “newly discovered” terrorist finance schemes.

However, the schemes were not new. In fact, they have been around for generations. As a result of my intelligence gathering and investigations overseas, I had been trying desperately to call attention to these systems. But for too long they were off the radar screen of our western-centric bureaucracies where management could relate to bank checks, wire transfers, and ATM machines but not the equally sophisticated ways of transferring value found around the world that are not part of our traditional culture.

Beginning in the early 1990s, I began to travel frequently to the Middle East. Prior to September 11, I probably had more investigative experience and contacts in the Middle East, particularly in the area of trade transshipments and money laundering, than any other U.S. law enforcement official. It was readily apparent that Dubai in the United Arab Emirates was developing into a laissez-faire commercial and money center. *Everything* goes through Dubai. The trails of transnational crime that I followed eventually led to Dubai. Despite the obvious, U.S. intelligence was not looking at Dubai itself but only used Dubai as a vantage point to focus on nearby Iraq and Iran. My continuous and documented appeals in 1993, 1994, 1995, and 1996 to open a U.S. law enforcement office in the Middle East and particularly Dubai were ignored.

Decision makers in Washington D.C. were too slow to recognize that they needed to move away from their focus on the U.S. law enforcement “Attache” network in Europe

that was put in place to help combat the Cold War. It was only after the investigation into the financing of September 11 and the realization that most of the terrorist funding passed through Dubai, coupled with the findings that A.Q. Khan, the Pakistan nuclear scientist and “father of the Islamic nuclear bomb” used Dubai for many of his front companies and laundering network, that official Washington took action and in 2004 placed permanent FBI and DHS/ICE investigators in the United Arab Emirates. We lost too much time. In my opinion, Dubai is still at the cross roads of illicit trade and finance in the Middle East and South Asia.

According to recent reports from the United Nations, poppy cultivation in Afghanistan soared almost 60% in 2006 and another 17% in 2007. Afghanistan produces over 90% of the world’s supply of opium. Much of the recent rise in production is coming from Taliban strongholds in the southern part of the country, particularly Helmand province. Trafficking in narcotics produces billions of illicit dollars every year in an area of the world that is quite hostile to western interests. Much of that illicit income is finding its way to terrorists.

Sadly, over six years after the U.S. and coalition partners entered into Afghanistan, we have made virtually no progress in understanding and identifying some of the entrenched South Asian money and value trails employed by our enemies.

During a 2006 trip to Kabul, I asked Afghan bankers, hawaladars, and businessmen how our adversaries were laundering narcotics proceeds and financing terrorism. Without

exception, they told me that dirty money was *not* being laundered via the 13 licensed banks then operating in Afghanistan – the focus of our efforts against terrorist finance. According to the Afghans, the value was laundered primarily through *trade*.

Opium poppy is one of the few things that Afghanistan produces that outsiders value. In fact, opium gum is often used as a currency, especially among rural farmers. Trading networks with sinister ties are also involved. While construction materials, foodstuffs, electronics, and necessities for rebuilding Afghanistan are flooding into the country via transit trade agreements with neighboring Pakistan and Iran, the hope and progress they bring are too often offset by the exchange for drugs flowing outside the country.

Most of the trade goods that enter Afghanistan are purchased in the regional shopping center of Dubai. Dubai has a liberal trading sector, modern infrastructure, transportation facilities, and efficient financial and business services. Dubai is also the regional hawala center. Trade is the primary means to transfer value in settling accounts between regional hawaladars. Trade fraud and over-and-under-invoicing are common and are often employed to launder money and transfer value. Moreover, Dubai has demonstrated direct ties to terrorist finance.

Regional misuse of trade acts as a kind of a laundering wash cycle. The cycle is creating a culturally unique South Asian-Arabian mix of business, finance, and drugs that – as a whole – is little understood but presents a clear and present danger to the region and our interests.



Unfortunately, our bureaucracies have not yet learned the lesson that traditional money laundering countermeasures that focus on large amounts of illicit money moving through banks will not prove effective in combating underground networks. Trade-based laundering of Afghan drug proceeds is another major “crack” that regional jihadists are exploiting.

The bottom line on measuring progress in traditional money laundering is best measured in successful prosecutions and convictions. Unfortunately, the record is not good. According to the State Department’s 2008 International Narcotics Control Strategy Report, Volume II on Money Laundering and Financial Crimes, “Far too many countries that boast solid anti-money laundering/counter terrorist finance (AML/CTF) standards and infrastructures are still simply not enforcing their laws. This is true in all corners of the world and for both developed and developing countries alike. A review of recent data demonstrates that some jurisdictions are having trouble converting their anti-money laundering policies and programs into investigations, prosecutions, and convictions. In some cases, the lack of enforcement is due to lack of capacity, but in far too many others it is due to a lack of political will. In addition, too many jurisdictions are getting caught up in the AML/CTF process and losing sight of the objective.”

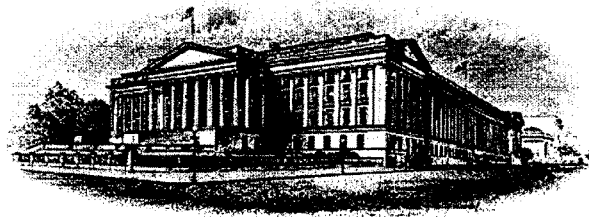
In the United States, prosecutorial statistics on AML/CTF are open to debate. However, there is no question that since the creation of the Department of Homeland Security, there has been a sharp drop-off in significant money laundering investigations as compared to the 1980s and 1990s. Why have noteworthy investigations disappeared? Since global

money laundering is currently estimated at approximately \$3 trillion a year, the logical conclusion is that there has been a lack of enforcement.

On May 13, 2003, a memorandum of agreement between the Department of Justice and the newly created Department of Homeland Security was signed, giving the FBI unprecedented control of investigations and operations related to terrorist finance. The FBI won its long standing rivalry with the Department of Treasury for primacy on terror finance. However, almost five years later, the non-results speak volumes about the wisdom of this policy.

In my opinion, the creation of the Department of Homeland Security and the simultaneous emasculation of the Department of Treasury's Office of Enforcement was the single most grievous mistake in our War on Terror Finance. Treasury (particularly, legacy Customs) boasted criminal investigators skilled in finance, smuggling, trade, fraud, and cross-border crime; the very elements involved in terror finance. When Customs was incorporated into the Department of Homeland Security, the accumulated expertise rapidly disappeared. Over the last few years, the mandate given to the new Immigration and Customs Enforcement (ICE) has been immigration. The Department of Treasury no longer has an enforcement arm. Particularly since September 11, we have emphasized regulatory "solutions" at the expense of enforcement. I believe this the primary reason why our government is so dependent on countermeasures that may sound impressive in testimony but have precious few real-world results.

Our War on Terrorist Finance is stalled. It is time to re-assess our efforts.



## **U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS**

**UNDER SECRETARY FOR TERRORISM AND  
FINANCIAL INTELLIGENCE STUART LEVEY**

### **TESTIMONY BEFORE THE SENATE COMMITTEE ON FINANCE**

WASHINGTON – Chairman Baucus, Ranking Member Grassley, and distinguished members of the Committee, thank you for the opportunity to speak with you today about the work of the Treasury Department’s Office of Terrorism and Financial Intelligence (TFI). I want to thank this Committee and the others that oversee TFI for the continued support and guidance we have received. Today, I want to brief you on the progress we have made over the past four years and also talk about some of the challenges we face moving forward.

#### **THE OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE AND THE TREASURY DEPARTMENT’S ROLE IN PROTECTING NATIONAL SECURITY**

Nearly four years have passed since I first testified before this committee as the nominee for my current position. At the time, I think it is fair to say that the extent of the Treasury Department’s future role in protecting U.S. national security was uncertain at best. Most of the Treasury’s law enforcement functions had been moved to the Departments of Justice and Homeland Security in 2003, the Treasury was not integrated into the Intelligence Community, and the office that I was being asked to lead was only in the process of being established.

But there were some who recognized that the Treasury Department’s efforts to protect the safety and soundness of the international financial system were indispensable to our national security, especially given the types of threats we face in a post -9/11 world. Globalization is a positive trend; open finance and free trade enhance the economic security and prosperity of people in this country and around the world. But illicit actors seek to abuse the global financial system to support their dangerous activities. The financing of terrorism and weapons proliferation often occurs within the same system that spreads prosperity at home and abroad. It was therefore important to adapt our national security strategy to confront this challenge. This was the genesis of the Office of Terrorism and Financial Intelligence, or TFI.

Fast-forward to today, and we have a Treasury Department that is playing a greater role in national security than ever before. The guiding principle of TFI's approach is that many of the threats we face – from terrorism to the proliferation of weapons of mass destruction (WMD) to narcotics trafficking – all have one thing in common: they rely on financial support networks. These threats are not neatly confined within the borders of another country. They are asymmetric and borderless and thus not necessarily susceptible to being solved exclusively by traditional means of deterrence. The Treasury is well-situated to address them because of the authorities we command, the relationships we possess with governments and private sector actors around the world, and the financial information we can draw upon.

Transactions by those engaged in threatening conduct typically leave a trail of detailed information that we can follow to identify key actors and map their networks. Opening an account or initiating a funds transfer requires a name, an address, a phone number. This information tends to be very accurate and durable. In 2004, with the creation of TFI's Office of Intelligence and Analysis, the Treasury became the first finance ministry in the world to develop in-house intelligence and analytic expertise to use this information. We now work with the broader Intelligence Community to communicate the Department's requirements and evaluate information that threatens our national security. The Treasury then considers this information with an eye toward potential action – be it a designation, an advisory to the private sector, or a conversation to alert the private sector and government officials in another country to a particular threat. The financial networks of these illicit actors are not only a rich source of intelligence, but also they are a vulnerability we can exploit. As I will explain, we have seen in various contexts that targeting these financial networks, when we do it right, can place an enormous amount of pressure on these networks and the actors they support.

#### **A. COMBATING THREATS WITH TARGETED FINANCIAL MEASURES**

As we have applied our authorities to different threats over the past several years, we have adopted a new strategy of using targeted, conduct-based financial measures aimed at particular bad actors. I intentionally refer to these targeted actions as “financial measures” rather than “sanctions” because the word “sanctions” often evokes such a negative reaction. These targeted financial measures are proving to be quite effective, flying in the face of a widely-held historical view that dismisses sanctions as ineffective, harmful to innocents, or both.

In the case of broad, country-wide sanctions that are often perceived as political statements, it can be difficult to persuade other governments and private businesses to join us in taking action. Even when other governments agree with us politically, they generally tend to be unwilling to force their businesses to forgo opportunities that remain open to others. When the private sector views such broad sanctions as unwelcome barriers to business, companies are unmotivated to do more than what is minimally necessary to comply. Indeed, history is replete with examples of participants in the global economy working to evade such sanctions while their governments turn a blind eye.

The dynamic is different when we instead impose financial measures specifically targeted against individuals or entities engaging in illicit conduct. When we use reliable financial intelligence to build conduct-based cases, it is much easier to achieve a multilateral alignment of interests. It is difficult for another government, even one that is not a close political ally, to oppose isolating actors who are demonstrably engaged in conduct that threatens global security or humanitarian interests. Also, whatever their political views, all countries want their financial

sectors to prosper and to have good reputations. They therefore share a common interest with us in keeping their financial sectors untainted by illicit conduct.

The key difference when we use targeted financial measures is the reaction of the private sector. Rather than grudgingly complying with, or even trying to evade these measures, we have seen many members of the banking industry, in particular, voluntarily go beyond their legal requirements because they do not want to handle illicit business. This is a product of good corporate citizenship and a desire to protect their institutions' reputations. The end result is that private sector voluntary actions amplify the effectiveness of government-imposed measures.

Once some in the private sector decide to cut off companies or individuals we have targeted, it becomes an even greater reputational risk for others not to follow, and so they often do. Such voluntary implementation in turn makes it even more palatable for foreign governments to impose similar measures because their financial institutions have already given up the business, thus creating a mutually-reinforcing cycle of public and private action.

Armed with the critical intelligence capability I have described, as well as our experience building and maintaining multilateral government and private sector support for our actions, TFI draws on any one or a combination of authorities to respond to a particular threat. In many circumstances, we have found that our most effective tool is simply sharing information about illicit actors with other governments and members of the international private sector.

I would now like to describe some of the results of this marriage of intelligence and strong financial authorities, and the role it plays across various elements of our national security strategy.

#### **1. Disrupting and Dismantling Terrorist Support Networks**

Our efforts to track and combat terrorist financing are critical pillars of the U.S. government's efforts to protect U.S. citizens and other innocents around the world from terrorist attacks. These efforts span across U.S. departments and agencies and range from intelligence collection and analysis to public actions aimed at holding terrorist financiers accountable for their conduct and deterring other would-be donors. Activities to combat terrorist financing are more integrated than ever before into the U.S. government's strategic approach to counterterrorism by virtue of the National Implementation Plan, which synchronizes the U.S. government's overall counterterrorism efforts.

Over the last four years, we have become more adept at pursuing that strategy and at pursuing the most appropriate course of action to combat the particular terrorism threat presented. In December of 2005, the 9/11 Commission's Public Discourse Project awarded its highest grade, an A-, to the U.S. government's efforts to combat terrorist financing. Since then, we have continued to develop and improve our strategy and there are signs that we are making important progress.

To start, we have made significant progress in mapping terrorist networks. "Following the money" yields some of the most valuable sources of information we have in this effort. As 9/11 Commission Chairman Lee Hamilton has stated: "Use of this tool almost always remains invisible to the general public, but it is a critical part of the overall campaign against al Qaida." That is because financial intelligence is extremely reliable; money trails don't lie. At times, our

best course is not to take public action, but to continue to trace the network both upstream to the ultimate donors and downstream to the operational cells.

On some occasions, we decide that the best approach is to share intelligence with other countries and urge them to take action against the relevant actors. We have found that almost all countries will take such requests very seriously, especially when the information concerns al Qaida.

At other times, we have determined that the best course is for the Treasury to take public action. We have a powerful Executive Order that allows us to designate terrorists and their supporters, freezing any assets they have under U.S. jurisdiction and preventing U.S. persons from doing business with them. We have used this authority against key terrorist entities, facilitators, donors, and terrorist-supporting charities, ranging from Bayt al-Mal and Yousser Company, which are financial institutions that functioned as Hizballah's unofficial treasury in Lebanon, to Adel Abdul Jalil Batterjee, a Saudi-based donor to al Qaida.

When it comes to al Qaida and the Taliban, there is a UN Security Council resolution, UNSCR 1267, which provides for designations similar to our Executive Order designations. There are other Security Council resolutions dealing with terrorist financing more generally, but for Hamas, Hizballah and other terrorist organizations we have designated, there is no comparable UN list. We are still grappling with this challenge. We nevertheless have found that our unilateral designations are followed voluntarily by many banks around the world that have decided they simply do not want to do business with these actors.

The disruptive impact of these actions is significant. Beyond the direct effect on the designated individual or entity, designations can also deter other would-be financiers. The terrorist operative who is willing to strap on a suicide belt may not be susceptible to deterrence, but the individual donor who wants to support violent jihad may well be. Terrorist financiers typically live public lives with all that entails: property, occupation, family, and social position. Being publicly identified as a financier of terror threatens an end to that "normal" life.

Designations have also been an effective tool in combating terrorist abuse of charities. Historically, al Qaida and other terrorist groups have set up or exploited some charities, preying on unwitting donors trying to fulfill their religious obligation of charitable giving or seemingly engaging in humanitarian activity to garner support from communities in need. Indeed, many terrorist-supporting charities have gone to great lengths in attempting to obscure their support for violence.

Through a combination of public designations and law enforcement and regulatory actions against corrupt charities, both at home and abroad, we have exposed and taken out key organizations and deterred or disrupted others. We have thus far designated approximately 50 charities worldwide as supporters of terrorism, including several in the United States, putting a strain on al Qaida's financing efforts.

There is also increased awareness among charities around the world of the danger of terrorist abuse. In that regard, our active engagement with the charitable sector has been just as important as our actions against specific charities that have supported terrorism. This is particularly important because we want humanitarian assistance to reach those who are truly in need through channels safe from terrorist exploitation.

We have issued guidance to assist charities in mitigating the risk of exploitation by terrorist groups. We have engaged in a comprehensive outreach campaign to the charitable sector and the Arab/Muslim-American communities to explain the threat, provide guidance, and address questions regarding Treasury enforcement actions. Internationally, we have worked through organizations like the Financial Action Task Force – or the “FATF,” the world’s premier standard-setting body on combating terrorist financing and money laundering – to develop and implement standards and best practices on preventing terrorist financing through charitable organizations. This effort has made it much more difficult for al Qaida and other terrorist groups to raise money through ostensibly mainstream charities while also helping well-intentioned donors support worthy causes.

The real value of all of our counter-terrorist financing efforts is that they provide us with another means of maintaining persistent pressure on terrorist networks. Terrorist networks and organizations require real financing to survive. The support they require goes far beyond funding attacks. They need money to pay operatives, support their families, indoctrinate and recruit new members, train, travel, and bribe officials. When we restrict the flow of funds to terrorist groups or disrupt a link in their financing chain, we can have an impact.

With respect to the terrorist group that poses the greatest threat to the United States, al Qaida, we have made real progress. We have disrupted or deterred many of the donors on which al Qaida used to rely. At the very least, these donors are finding it far more difficult to fund al Qaida with the ease and efficiency provided by the international financial system. The same applies to many of the charities that al Qaida previously depended upon as a source of funds. To the extent we can force terrorists and their supporters out of the formal financial system, we force them into more cumbersome and riskier methods of raising and moving money, subjecting them to a greater likelihood of detection and disruption. In this regard, we are also pursuing important efforts to facilitate the interdiction of cash couriers, for example by working with DHS to identify and interdict them. The Department of Homeland Security’s Customs and Border Protection is playing a leading role in this global effort.

Along with our allies around the world, we have disrupted many of al Qaida’s most important facilitation networks. Consider this relatively recent quote from an interview by a high-ranking al Qaida official, Mustafa Abu-al-Yazid, also known as Shaykh Sa’id:

“As for the needs of the Jihad in Afghanistan, the first of them is financial. The Mujahideen of the Taliban number in the thousands, but they lack funds. And there are hundreds wishing to carry out martyrdom-seeking operations, but they can’t find the funds to equip themselves. So funding is the mainstay of Jihad. . . . And here we would like to point out that those who perform Jihad with their wealth should be certain to only send the funds to those responsible for finances and no other party, as to do otherwise leads to disunity and differences in the ranks of the Mujahideen.”

Al Qaida’s expression of concern about its financial difficulties is not limited to this one comment; this concern has recently been echoed elsewhere in al Qaida’s upper ranks. This, in part, is the impact of being forced out of the formal financial system. Al Qaida has had no choice but to turn to less reliable methods of raising, storing, and moving money, giving rise to opportunities for fraud and distrust within its ranks.

The overall impact of all of our efforts has been substantial: as DNI McConnell recently testified, over the last year to 18 months we have seen that the core leadership of al Qaida has had difficulty raising funds and sustaining itself.

That does not mean that I am satisfied; there are still tough issues that need to be tackled. One of our greatest challenges will be to foster the political will required to deter terrorist financiers more consistently and effectively. It has proven difficult to persuade officials in some countries to identify and to hold terrorist financiers publicly accountable for their actions. This lack of public accountability undermines our ability to deter other donors. Those who reach for their wallets to fund terrorism must be pursued and punished in the same way as those who reach for a bomb or a gun. We have made some progress in this area, but we have a long way to go. So long as that is the case, even when we are successful in disrupting terrorist facilitators and financial conduits, our successes may well be short-lived.

Stemming the violence in Iraq continues to be a significant challenge, but TFI is contributing to the effort. Our intelligence work has been particularly useful in helping to restrict the flow of funds fueling the Iraqi insurgency. The Treasury and Defense Departments established in late 2005 a Baghdad-based interagency intelligence unit, known as the Iraq Threat Finance Cell (ITFC), to enhance the collection, analysis, and dissemination of timely and relevant financial intelligence to combat the insurgency. The ITFC has made significant contributions to our war fighters. Senior U.S and Coalition military commanders have come to rely on the cell's strategic and tactical analysis to help combat the Iraqi insurgency and disrupt terrorist, insurgent, and militia financial networks.

The presence of al Qaida in Iraq is representative of another trend that poses a significant challenge for us. In the years since September 11, al Qaida has continued to merge with regionally-based terrorist groups to support its cause. Although these partners, which include groups based in Africa, the Middle East and elsewhere, may have had long-standing objectives of using terrorist tactics against governments and regimes, their affiliation with al Qaida brings with it the potential that their personnel and resources could be used to engage in attacks globally including against the United States. Our challenge is to stay in front of this trend by working to understand these groups' operations, organizational structure and, of course, their financial networks, as quickly as they are evolving. By focusing on the financing of these nodes, we can better understand the relationship among them and identify potential vulnerabilities.

We are also not yet where we need to be with respect to State Sponsors of Terrorism, particularly Iran and Syria. These states not only provide support and safe haven to terrorists, but also a financial infrastructure that terrorists can use to move, store, and launder their funds. Iran poses the biggest problem in this area, using its Qods Force to provide weapons and financial support to the Taliban and terrorist organizations. We have designated individuals or entities in both Iran and Syria for supporting terrorism-related activities, and, as in other areas, we find that responsible financial institutions take these actions into account and adjust their business accordingly.

Finally, there is only so much that the United States can do alone. We have good cooperation from many other governments and the private sector on counter-terrorist financing. The work of the UN Security Council in implementing Security Council Resolution 1267 and the FATF in setting international standards has been instrumental. But there are still challenges. Legal authorities and operational capacity to combat terrorist financing on a national level remain



uneven. Some countries still have not criminalized terrorist financing; others have taken this step, but have yet to use the authority. Most importantly, countries need to develop and apply intelligence as a basis of disrupting terrorist financing networks through law enforcement as well as through the use of targeted financial measures. Even some of our best partners still lack the political will or national authorities to consistently and aggressively disrupt terrorist financing networks. This is particularly true when it comes to terrorist groups beyond al Qaida or when there is need to rely on intelligence as a basis for financial action.

## **2. Targeting Proliferators and their Supporters**

We are applying the lessons we have learned in combating terrorist financing to respond to the threat of WMD and missile proliferation. Targeted financial action against proliferation networks has the potential to be particularly effective for two reasons. First, while terrorist organizations are likely to use informal networks or cash couriers, proliferation networks often engage in ostensibly legitimate commercial transactions and therefore tend to depend upon access to the formal financial system, where transparency and our controls are greatest. Second, many in the proliferation chain are motivated by profit, rather than ideology, making them more susceptible to deterrence if we can credibly threaten to publicly expose or isolate them.

Recognizing this, President Bush issued Executive Order 13382 in June of 2005, adding targeted financial measures to the array of options previously available to the U.S. government to combat proliferation. This order authorizes the Treasury and State Departments to target key nodes of WMD and missile proliferation networks, including their suppliers and financiers, in the same way we do with terrorists. We have used it to designate a number of banks, entities, and individuals supporting proliferation activities in Iran, North Korea, and Syria.

In the Iran context, UN Member States are implementing targeted financial measures against entities and individuals identified by the Security Council in a series of Chapter VII UN Security Council resolutions for their involvement in Iran's nuclear and missile programs. Beyond that, most governments do not yet have a national-level designation authority similar to ours as a tool to stem proliferation. Nonetheless, U.S. designations in this area gain worldwide recognition, particularly among financial institutions. My colleagues and I have traveled worldwide explaining our actions to, and sharing information with, foreign government officials and private sector representatives to help them understand the nature of the threat. The result is that our actions jeopardize designated proliferators' access to the international financial system and put their commercial partners on notice of the threat they pose. Those who continue to do business with them do so at the risk of tainting their reputations or even being designated themselves.

We also continue to work bilaterally and multilaterally to raise awareness of the problem of WMD proliferation finance and to encourage the creation of authorities like those we have under our Executive Order. We have been working closely with our G-7 Finance Ministry counterparts, in particular, to determine what steps can be taken to isolate proliferators from the international financial system through multilateral action. One of the most promising avenues is the recent and ongoing work of the FATF to study the threat of proliferation finance and assess the types of actions countries can take to prevent and disrupt proliferators' financial activities. This work has been strongly and unanimously endorsed by the G7, and we hope it will lead to international standards and best practices on proliferation finance, much like we already have on terrorist financing and money laundering. The Treasury and State Departments are also working to encourage the more than 85 countries that participate in the Proliferation Security Initiative (PSI)

– aimed at stopping shipments of weapons of mass destruction, their delivery systems, and related materials to state and non-state actors of proliferation concern – to use financial measures to combat proliferation support networks.

### **3. Combating the Illicit Financial Conduct of Rogue Regimes**

States engaged in illicit conduct pose a particular challenge. They hide behind a veil of legitimacy, disguising their activities, such as weapons sales or procurement, through the use of front companies and intermediaries. In some cases, they intentionally obscure the nature of their financial activities to evade detection and avoid suspicion. We have had important successes countering the illicit financial activity of both North Korea and Iran by using a combination of financial measures, fueled by financial intelligence, to target their conduct in a way that is persuasive both for other governments and the private sector.

#### *North Korea*

Confronted with North Korean conduct ranging from WMD and missile proliferation-related activities to the counterfeiting of U.S. currency and other illicit financial behavior, the Treasury Department took two important public actions. First, we targeted a number of North Korean proliferation firms under E.O. 13382. Second, we acted under Section 311 of the USA PATRIOT Act to protect our financial system from abuse by Banco Delta Asia, a Macau-based bank that, among other things, knowingly allowed its North Korean clients to use the bank to facilitate illicit conduct and engage in deceptive financial practices.

Much of the real impact of these actions came from the information we made public in conjunction with the actions and the information we shared with governments and banks around the world. The private sector's reaction was dramatic. Since the information pointed to the North Korean regime's involvement in the illicit conduct, many of the world's private financial institutions terminated their business relationships not only with designated entities, but with North Korean clients altogether. Banks in China, Japan, Vietnam, Mongolia, Singapore and across Europe decided that the risks associated with this business far outweighed any benefit. The result has been North Korea's virtual isolation from the global financial system. That, in turn, put enormous pressure on the regime – even the most reclusive government depends on access to the international financial system. This effort was valuable both in securing the integrity of the international financial system and in providing the State Department with leverage in its diplomacy with North Korea.

In addition to these public actions, we have continued to work with the U.S. Secret Service to counteract North Korea's counterfeiting of U.S. currency. The Secret Service is continuing to investigate North Korea's counterfeiting activities and the high-quality counterfeit bills produced by North Korea, known as the "Supernote," continue to surface.

#### *Iran*

Dealing with Iran – a country that is much more deeply integrated into the international financial system than North Korea – has presented an even more complex challenge. Iran poses a number of threats. Among them are the regime's continued pursuit of nuclear capabilities in defiance of UN Security Council resolutions and its provision of financial and material support to terrorist groups. The combination of these dangerous activities has an extraordinarily lethal potential. Iran

uses its global financial ties to pursue both policies, and it engages in an array of deceptive financial conduct specifically designed to avoid suspicion and evade detection by regulators and law-abiding financial institutions. By combating Iran's illicit financial activities with a strategy that combines targeted financial measures with an unprecedented level of outreach around the world, the Treasury is playing an integral role in the U.S. and multilateral strategy for dealing with Iran.

Iran's financial conduct underlies its proliferation and terrorism activities. Iran uses its state-owned banks for its nuclear and missile programs and for financing terrorism. It also uses front companies and intermediaries to engage in ostensibly innocent commercial transactions that are actually related to its nuclear and missile programs. These front companies and intermediaries enable the regime to obtain dual-use technology and materials from countries that would typically prohibit such exports to Iran.

We have also seen how Iranian banks request that other financial institutions take their names off of transactions when processing them in the international financial system. This practice is intended to evade the controls put in place by responsible financial institutions and has the effect of threatening to involve them in transactions they would never engage in if they knew who, or what, was really involved. This practice is even used by the Central Bank of Iran.

Over the past year and a half, I and other senior Treasury officials have met with our finance ministry and central bank counterparts from around the world to discuss the importance of ensuring that the international financial system is not tainted by Iran's abuse. We have also met with scores of banks to share this information and to discuss the risks of doing business with Iran.

We have taken targeted financial action under our proliferation and terrorism Executive Orders against key Iranian banks, entities and individuals facilitating the regime's dangerous conduct. Among these designations, we have acted against state-owned Bank Saderat, which has been used by the regime to funnel money to terrorist organizations. We have also designated three other Iranian state-owned banks – Bank Sepah, Bank Melli, and Bank Mellat – for facilitating the regime's proliferation activities and designated the Qods Force under our terrorism Executive Order for providing material support to the Taliban and terrorist organizations. The State Department has designated other key entities of proliferation concern, including the Islamic Revolutionary Guard Corps (also known as the Iranian Revolutionary Guard Corps) and the Ministry of Defense and Armed Forces Logistics.

These U.S. efforts have been accompanied by international action. The State Department's intensive diplomatic efforts have resulted in three UN Security Council resolutions imposing sanctions on Iran for its pursuit of nuclear capabilities and ballistic missiles. The most recent resolution, UNSCR 1803, calls upon UN member states to exercise vigilance over their own financial institutions' activities with all financial institutions domiciled in Iran, and their branches and subsidiaries abroad. This provision makes special mention of the risks posed by Bank Melli and Bank Saderat. And, in February, the FATF issued its second statement on Iran, sending a clear message to governments and financial institutions worldwide about the threat Iran poses to the international financial system.

In response to Resolution 1803 and the FATF's warning, Treasury's Financial Crimes Enforcement Network (FinCEN) issued an advisory on March 20 to U.S. banks warning them of

the risks of doing business with Iran and identifying Iranian state-owned and private banks and their branches and subsidiaries abroad. We also warned financial institutions about the conduct of the Central Bank of Iran, both in obscuring the true parties to transactions and in helping Iranian proliferation and terrorist-supporting entities avoid sanctions.

The overall result has been just the type of mutually-reinforcing cycle of governmental and private sector action that I previously described. In reaction U.S. and multilateral actions, the world's leading financial institutions have largely stopped dealing with Iran, and especially Iranian banks, in any currency. Foreign-based branches and subsidiaries of Iran's state-owned banks are becoming financial pariahs – threatening their viability – as banks and companies around the world resist dealing with them. This represents a substantial success in protecting the integrity of the financial system from Iranian illicit conduct while simultaneously providing leverage to support the multilateral effort to reach a negotiated solution on Iran's nuclear program.

#### **4. Combating other Threats**

Our use of targeted financial measures is not limited to combating terrorism, proliferation, and the illicit financial conduct of Iran and North Korea. We are also using these tools in a variety of other contexts, including against corruption, narcotics trafficking, and abusive and oppressive regimes. In all of these situations, we can help put pressure on specific bad actors and try to rally the private sector to isolate them from the international financial system. Of course, these financial measures cannot alone solve these types of intractable problems. They are just one component of broader U.S. and, in some cases international, strategies to address them.

##### *Combating Corruption*

Corruption is one of the newer areas where we are increasingly relying on targeted financial measures. Corruption erodes democracy, the rule of law and economic well-being around the world. It taxes the poor, deprives legitimate businesses of opportunity and breeds criminality and mistrust. To address this threat, the President announced a strategy in August 2006 to combat high-level corruption, or “kleptocracy.” The Treasury's charge in this strategy is to ensure that the international financial system is not misused by kleptocrats seeking to hide or move their ill-gotten gains. We also have targeted financial authorities aimed at exposing and disrupting corrupt officials' financial networks in countries such as Belarus, Burma and Syria.

In addition to the use of targeted financial measures to combat corruption, we are also working to increase transparency in the U.S. domestic and international financial systems, ensuring that an appropriate level of due diligence is applied to the financial dealings of foreign officials in positions of public trust, otherwise know as “Politically Exposed Persons,” or PEPs.

##### *Addressing Human Rights Abuses and Oppressive Regimes*

In the past several years, we have learned that targeted financial measures can play a helpful role in reinforcing broader strategies to address human rights abuses and the conduct of brutal and oppressive regimes. Our efforts span across the crisis in Darfur to human rights violations and other oppressive activities in Zimbabwe, Burma, and Belarus. In the context of Darfur, for example, we have used the precision of targeted financial measures to focus on those who foment violence and human rights abuses. Our designations have included Sudanese individuals,

including government and rebel leaders, elements of the logistical support network that arm those committing atrocities, and companies tied to the regime. These actions supplement an already comprehensive country sanctions program and have played an important role in exposing ongoing atrocities and bringing a new element – the financial sector – into the fight to bring them to an end. In the context of Burma, we have designated key financial operatives of the Burmese regime and their business networks.

#### *Combating Narcotics Trafficking*

No discussion of the success of targeted financial measures would be complete without mention of the Treasury Department's counternarcotics sanctions program. This program has been in place since 1995, when President Clinton issued an Executive Order targeting the activities of significant foreign narcotics traffickers in Colombia, with the objective of isolating and incapacitating the businesses and agents of the Colombian drug cartels. Designations under this order continue today and span multiple industries, including such enterprises as drugstore chains, construction firms, agricultural businesses, and department stores. This program was the model in 1999 for the Foreign Narcotics Kingpin Designation Act ("Kingpin Act"), which provides a statutory framework for the President to impose sanctions against foreign drug kingpins and their organizations on a worldwide scale. Targets under the Kingpin Act have been identified in Mexico, the Caribbean, Middle East, and Southeast Asia.

This program has achieved many successes. Among them is the historic September 2006 plea agreement between the U.S. government and Miguel and Gilberto Rodriguez-Orejuela, the brothers who ran the infamous Cali Cartel in Colombia, which was responsible for importing tons of cocaine into the United States during the past two decades. According to the plea agreement, the Rodriguez-Orejuela brothers admitted smuggling over 30 metric tons of cocaine into the United States, generating an illicit fortune in excess of one billion dollars. Treasury, Justice, and other law enforcement agencies had for years worked to uncover and immobilize the hidden assets of the Cali Cartel, with the Office of Foreign Assets Control (OFAC) designating hundreds of front companies and individuals in Colombia and 10 other countries. In the end, the Rodriguez-Orejuela brothers were willing to plead guilty and spend the rest of their lives in jail just to make their family members eligible to be removed from OFAC's list.

#### **B. SAFEGUARDING THE INTEGRITY OF THE FINANCIAL SYSTEM**

Our efforts to combat threats to our national security using our financial authorities are most effective when they build on a foundation of strong systemic safeguards in the financial sector. Indeed, one of the Treasury's core missions is to ensure that these safeguards are part of our own domestic financial system and to encourage the adoption of similar safeguards worldwide. The common thread that runs throughout these initiatives is the goal of bringing greater transparency to the international financial system.

Transparency is, in and of itself, a powerful safeguard against the kinds of abuse of the financial system that I have described today. It is critical to enabling financial institutions and law enforcement, regulatory and other authorities to identify sources and conduits of illicit finance so that they can take steps to protect themselves, contributing to the overall safety, soundness, and security of the international financial system. Their efforts, in turn, deny terrorist organizations, proliferators and other criminals access to the financial system, forcing them to adopt costlier and riskier alternative financing mechanisms. We work to promote security by:

- Understanding how illicit actors abuse the financial system and ensuring that the U.S. financial system is protected by a comprehensive, efficient, and rigorously enforced anti-money laundering/counterterrorist financing (AML/CFT) regime;
- Strengthening and expanding international AML/CFT standards;
- Taking protective actions against threats and systemic vulnerabilities; and
- Partnering with the private sector.

I would like to share with you some of the actions we are taking to meet each of these objectives.

**1. Understanding How Illicit Actors Abuse the Financial System and Ensuring the Protection of that System**

The first step in safeguarding the financial system is to understand where it is vulnerable and the threats it faces. The Treasury Department has worked for many years to improve its understanding of illicit finance, and, in 2006, we coordinated the first U.S. government-wide Money Laundering Threat Assessment. The assessment brought together the expertise of regulatory, law enforcement and investigative officials from across the government to investigate the current and emerging trends and techniques used to raise, move and launder illicit proceeds. Following the assessment, the Treasury joined with the Departments of Justice and Homeland Security to craft the 2007 National Money Laundering Strategy, which is mapped explicitly to the vulnerabilities identified in the threat assessment.

The Treasury is working with other agencies to ensure that we are appropriately addressing these threats. Highlights of this effort include FinCEN's ongoing efforts to analyze Bank Secrecy Act (BSA) filings to provide geographic threat assessments, such as the 43 State-specific reports provided to State regulators last year, analysis of Suspicious Activity Report (SAR) filings related to the districts of individual U.S. Attorney offices, and the ongoing analytical work in the area of mortgage fraud following FinCEN's first published report on that topic in November 2006. FinCEN also continues its coordination with the IRS and law enforcement agencies to identify potentially unregistered money services businesses and to target those businesses with outreach, education, and, where appropriate, enforcement efforts.

In addition to taking these specific steps, we are constantly examining our regulatory system to ensure it is as efficient and effective as possible. In that regard, on June 22, 2007, Secretary Paulson announced the first in a series of ongoing initiatives to promote the efficiency and effectiveness of the AML/CFT regulatory framework. FinCEN has been working with the Federal Banking Agencies and other government authorities, and in the coming months will be taking public steps in the areas previewed by the Secretary, including discussing the results of our efforts with the banking regulators to enhance risk-scoping in the bank examination process; proposing a clearer and more tailored regulatory definition of money services businesses; and proposing a restructured set of regulations to enable covered industries to focus more quickly on rules that apply specifically to them. Moreover, FinCEN continues to provide feedback to the financial industry on the usefulness to law enforcement of reported information and through analytical studies, guidance, and advisories to help financial institutions better target their risk control activities.

Strong enforcement of our money laundering and sanctions laws also plays an important role in protecting the financial system from abuse. The Department of the Treasury works with its other financial regulatory colleagues to administer and promote understanding of, and compliance

with, these laws. Most enforcement in this area is civil, involving the banking regulators, OFAC, or FinCEN. In cases of serious violations, however, criminal enforcement may be warranted.

In the summer of 2005, the Department of Justice amended the United States Attorneys' Manual to require that all money laundering prosecutions of financial institutions be coordinated with, and approved by, the Criminal Division in Washington. The Manual contains a similar provision for cases under the International Emergency Economic Power Act – or IEEPA – which is one of the principal statutory authorities for OFAC's sanctions programs. These provisions promote consistency and uniformity in the use of these statutes and help ensure that unintended consequences from relevant cases are minimized. In that regard, they were specifically designed to enable Justice to consult with other agencies, including the Treasury Department. In enforcement actions involving violations of the BSA, Justice and the Treasury attempt to act concurrently whenever possible to promote consistency and avoid multiple actions against the same financial institution at different times for similar and related conduct.

The continued consultation between the Justice and Treasury Departments is vitally important given the complexities surrounding potential criminal charges against banks and other financial institutions, including the potential impact of such cases on the U.S. financial system. Under Assistant Attorney General Alice Fisher's leadership, the right atmosphere has been created for that consultation. In the end, the U.S. government must strike a delicate balance. We need to ensure the proper respect for the laws that safeguard the integrity of our financial system, but do so in a way that (1) allows our civil regulatory system to function effectively and (2) ensures that we maintain our position of leadership in the global financial system. This requires the exercise of well-informed and wise prosecutorial discretion. Consultation between the Treasury and Justice is an important part of that process.

## **2. Strengthening and Expanding International AML/CFT Standards**

Given the global nature of the financial system, focusing only on the U.S. financial system and its AML/CFT regime is not sufficient. Safeguarding the U.S. financial system requires global solutions and effective action by financial centers throughout the world. We work toward this objective through multilateral bodies that set and seek to ensure global compliance with strong international standards.

The Treasury Department primarily advances this strategic objective through FATF, which articulates standards in the form of recommendations, guidelines, and best practices. The FATF standards have been recognized by more than 175 jurisdictions and have been integrated into the work of international organizations such as the United Nations, the World Bank and the International Monetary Fund. The FATF seeks global implementation of its standards through a number of mechanisms. Partnership with the IMF, World Bank and FATF-Style Regional Bodies ensures that every country in the world is assessed against the same standards using the same methodology. AML/CFT is one of twelve core standards used by the IMF to evaluate financial sector stability and is the sole required standard for all countries. As of September 2007, the IMF had conducted 50 assessments -- four of which were done jointly with the World Bank -- of country compliance with AML/CFT standards. These assessments highlight the key deficiencies for countries seeking to improve their AML/CFT standards. We have seen steady progress in legislation by countries to address their deficiencies identified in their assessments. Assessments also highlight deficiencies in a way that is useful to the private sector in assessing risk.

In some cases, implementation of AML/CFT standards is a question of political will. In other cases, however, countries need help to comply with the standards. In such cases, the Treasury has worked through its Office of Technical Assistance and other agencies to provide technical assistance to support the development of legal authorities and operational capacity that will enable countries to meet these standards.

While we work to ensure the current standards are being implemented, we also have consistently engaged the FATF to expand and strengthen these international standards to address the systemic vulnerabilities that terrorists and other criminals exploit. Most recently, we have successfully engaged the FATF to adopt a new international standard to combat the illicit use of cash couriers, and we have enhanced the international standard for combating terrorist abuse of charities.

Not only does this investment in foreign capacity building make it more difficult for illicit actors to hide and thrive, it also opens up new avenues to share information across borders. For this purpose FinCEN is the designated financial intelligence unit (FIU) for the United States and has played a leading role in fostering the sharing of financial intelligence among the FIUs of 106 countries that are members of the Egmont Group.

One new and promising initiative that touches on these important issues is the Merida Initiative – a U.S.-proposed multi-year cooperation initiative with the governments in Mexico and the countries of Central America. For Fiscal Year 2008, the Administration has requested \$500 million for Mexico and \$50 million for Central America to fulfill U.S. obligations under the initiative. This would be the first tranche of a potential \$1.4 billion multi-year package. The assistance proposed falls into three broad areas: counternarcotics, counterterrorism, and border security; public security and law enforcement; and institution-building and the rule of law. A key part of the effort will be to modernize the Mexican financial intelligence unit's ability to respond more effectively to the evolving nature of money laundering. Overall, this initiative would complement existing U.S.-Mexico and Central America cooperation in countering the cross-border movement of billions of dollars in drug proceeds and in restricting the placement of these illicit proceeds into the U.S. financial system.

### **3. Taking Protective Action against Systemic Vulnerabilities**

Although it is important to focus on improving transparency and ensuring adequate AML/CFT controls are in place on a global level, there are also times when specific, discrete vulnerabilities are not adequately addressed in the international financial system. In those cases, we need to take action to warn the financial industry of the risks and to protect ourselves from the threat those vulnerabilities pose to our financial system.

In that regard, Section 311 of the USA PATRIOT Act – which I mentioned briefly in the context of our efforts on North Korea – is an important and extraordinarily powerful tool. Section 311 authorizes the Treasury to designate a foreign jurisdiction, foreign financial institution, type of account or class of transactions to be of “primary money laundering concern,” thereby enabling the Treasury to impose any one or combination of a range of special measures that U.S. financial institutions must take to protect against illicit financing risks associated with the designated target. We are the only country in the world that has an authority to take such protective action.



The Treasury has utilized Section 311 against both jurisdictions and financial institutions that posed a serious money laundering concern. When we have designated an entire jurisdiction – such as the Ukraine or Nauru – we have done so as part of, or in response to, a multilateral action, such as a FATF determination that these countries were “non-cooperative” on AML/CFT issues. One of the things that makes the Section 311 authority unique, however, is that it also allows us to finely target our actions so that we can protect ourselves from the threat that an individual financial institutions poses. This gives us enormous flexibility in determining how best to apply this authority to achieve the desired impact.

Our use of Section 311 has been extremely effective. Not only have our Section 311 designations had a significant effect in protecting the U.S. financial system, but they also have spurred actions by other countries that have the result of protecting the broader international financial system. In some instances, designation under Section 311 has facilitated the development of rehabilitative measures by a financial institution or jurisdiction that effectively addressed the underlying systemic vulnerability to the extent that withdrawal of the 311 designation was warranted.

#### **4. Partnership with the Private Sector**

Finally, we know that it is not sufficient to work only in partnership with governments on strengthening AML/CFT standards and identifying and closing specific vulnerabilities to the financial sector. The private sector brings a unique and invaluable insight into how the international financial system works and how we can be effective in achieving our objectives. We have forged important partnerships with both the domestic and international private sector to tap into and better utilize their expertise.

On the domestic side, Congress established the Bank Secrecy Act Advisory Group (BSAAG) in 1992 to enable the financial services industry and law enforcement to advise the Secretary of the Treasury on ways to enhance the utility of BSA records and reports. Since 1994, the BSAAG has served as a forum for industry, regulators, and law enforcement to communicate about how SARs and other BSA reports are used by law enforcement and how recordkeeping and reporting requirements can be improved. Under the chairmanship of the Director of FinCEN, the BSAAG meets twice a year in plenary and through multiple subcommittees over the course of the year. It has become an increasingly active group in suggesting priorities and to promote the efficiency and effectiveness of BSA rules and regulations.

On an international scale, we collaborated effectively with the private sector on the issue of “cover payments.” Cover payment transactions occur typically with respect to foreign correspondent banking, where the actual movement of funds is made through one or more intermediary banks that “cover” the payment amount, but the intermediaries do not know on whose behalf they are settling a given transaction. It became increasingly clear to many banks that this practice, which developed over time for a variety of commercial reasons, is inconsistent with international AML/CFT standards, in particular with the purpose behind FATF Special Recommendation VII requiring that originator information remain with the funds transfer throughout the payment chain.

Industry representatives raised with the Treasury Department the issue of vulnerabilities of cover payments—together with a proposal on how to rectify the situation in the most efficient way. In April 2007, the Clearing House Association – a provider of payment services owned by the U.S. affiliates of almost two dozen major banks – and the Wolfsberg Group – an association of 12

global banks – proposed an amendment to the global bank messaging standards to incorporate all relevant transaction information. That proposal was refined and endorsed by national bank groups in January 2008, and SWIFT, the Society for Worldwide Interbank Financial Telecommunication, will introduce the new message standards in November 2009. In addition to the technical changes, these groups of leading global banks announced payment message standards that they would follow to further enhance transparency in international payments, and thereby help avoid abuse by individuals and organizations that these banks would not accept as their own customers, such as money launderers and terrorist financiers. The Treasury Department, together with the Federal Banking Agencies, has engaged with their counterparts through the Basel Committee on Banking Supervision, FATF and the Egmont Group to promote a consistent global approach to ensuring compliance with these emerging global best practices.

The Treasury has also spearheaded an important initiative, the Private Sector Dialogue (PSD), to facilitate dialogue between U.S. financial institutions and their counterparts in key regions on AML/CFT issues. Our goal for these dialogues, which focus on the Middle Eastern and North African and Latin American banking and regulatory communities, is to raise awareness of domestic and regional money laundering and terrorist financing risks, international AML/CFT standards and regional developments, and U.S. government policies and private sector measures to combat terrorist financing and money laundering. These dialogues are also helping us to assess the impact of these international standards and U.S. laws and regulations and to strengthen development and implementation of effective AML/CFT measures, particularly in regions of strategic importance and jurisdictions that lack fully-functional AML/CFT regimes.

#### **CONCLUSION**

Over the past four years, I believe that, with your active support, we have transformed the Treasury Department into an important part of our country's national security architecture. We have greatly improved our ability to analyze and use financial intelligence. We have further developed and implemented strategies for combating terrorist financing and other pressing threats to our national security, including through the innovative use of targeted financial measures against specific bad actors. These strategies, particularly in the cases of North Korea and Iran, have provided valuable leverage in difficult diplomatic negotiations. We have also made important strides in strengthening the systemic safeguards in the financial system both here in the United States and around the world. But our work is not nearly complete. We continue to face significant challenges as we move forward with these efforts, including fostering and maintaining the political will among other governments to take effective and consistent action.

I look forward to continuing to work with this Committee as we tackle these challenges.

